

AN ORGANISATION THEORY PERSPECTIVE ON CHOICE OF FRANCHISING  
FORM

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## ABSTRACT

This research addresses the issue of diversity of organisational forms in franchising, which despite its prevalence, is poorly understood. The research focuses on the choice between three categories, consisting of five common types, of franchising: single-unit franchising, direct multi-unit (sequential franchising and area development) and indirect multi-unit (area representation and subfranchising) franchising forms.

The thesis presents and tests a contingency model that explores the influence of environmental (munificence, complexity and dynamism) and task (task complexity) uncertainties on choice of franchising form. Six factors were operationalised to represent environmental and task uncertainties. These factors included demand size and growth (environmental munificence), demand dispersion and heterogeneity (environmental complexity), intensity of rivalry (environmental dynamism) and task complexity (task uncertainty).

A multi-case study research strategy was conducted to test the contingency model. The strategy involved interviews with founders, other franchisor executives and franchisees, and also considered documentation and direct observations. The sample comprised a heterogeneous selection of seven New Zealand founded franchise systems. Companies were theoretically selected to ensure all five types of franchising were represented.

The findings illustrated general support for the thesis that environmental and task uncertainties do influence choices made between alternative franchising forms. Most companies adopted types of franchising that were consistent with expectations derived from the model. Importantly, however, the overall fit was not neat and conclusive. The explanatory power of individual factors varied and in some situations form choices occurred contrary to expectations.

This research produced further important findings. The qualitative methodology employed helped uncover five further drivers of franchising form choice. These additional factors related to individual choice and the firm, and included incentives, growth aspirations, need for control, resource constraints and franchisee aspirations.

The findings also confirmed that no one factor or theory was sufficient to explain form choice, and the factors important in one company's decision might have little relevance to another's. Consequently, multiple perspectives were necessary to understand the decisions made by franchisors.

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# CHAPTER 1

## INTRODUCTION AND CONCEPTUAL MODEL

### Introduction

There are two aspects to franchising that justify greater attention to this phenomenon from organisation and management scholars. First, franchising is becoming ubiquitous. Over one-third of all retail sales in the United States pass through franchises making franchising a dominant mode of retail entrepreneurship in the United States (Bradach, 1997; Shane, 1998). The growth rate of franchising is comparable to that of the U.S. economy as a whole since 1986, with more than 200 new franchises appearing each year (Lafontaine & Shaw, 1998; Shane & Spell, 1998). Second, franchising is a complex phenomenon (Bradach & Eccles, 1989). Outwardly, the franchise chain may seem like a simple organisational form seeking to provide a standardised product or service. McDonalds exemplifies this replication of a simple business concept, providing stringent selection, training, operating and monitoring practices, so that customers receive a similar experience at over 8,000 restaurants in the United States and 26,000 worldwide. While units of this franchise system and many others appear strikingly similar, beneath may reside complex strata of heterogeneous organisational arrangements. Franchising can be simultaneously viewed as an organisational arrangement, a governance mechanism or a resource exchange process. Even as an organisational arrangement, it is puzzling for two reasons. First, franchise systems often comprise both company-owned and franchised units (Brickley & Dark, 1987; Caves & Murphy, 1976; Lafontaine & Kaufmann, 1994; Rubin, 1978; Shane, 1996). Second, franchised units can be linked to the franchisor through two arrangements called single-unit and multi-unit franchising (Bradach, 1995; 1998; Kaufmann, 1992; Kaufmann & Dant, 1996, 1998; Kaufmann & Kim, 1995; Lowell, 1991). To add to this complexity, multi-unit forms consist of a variety of organisational designs that can be categorised as direct and indirect forms. Despite its ubiquity and enigmatic nature, franchising is scarcely mentioned in books that survey the literature in organisation theory (Bradach, 1997).

This thesis seeks to integrate franchising with extant organisation theory and is motivated by a view of franchising primarily as an organisational arrangement. It addresses the issue of diversity of organisational forms in franchising, which despite its prevalence, is poorly understood (Bradach, 1995, 1998; Kaufmann & Dant, 1996; Kaufmann & Kim, 1995). I build on a structural contingency perspective to argue that environmental and task contingencies shape organisational forms by influencing organisational design criteria. I specify these criteria and show how each design criterion is associated with *ex ante* and *ex post* transaction costs. In doing so, I seek to shed light on the organisational design decisions in franchising by elucidating the role of transaction costs in influencing the choice of organisational form. Analysing the phenomenon of franchising as an organisational arrangement, I seek to contribute to organisation theory by unbundling the concept of fit in terms of transaction costs and by showing how these costs are embedded in specific environmental and task contexts.

This chapter is arranged as follows. First, I present basic aspects of business format franchising and define the five dominant organisational forms in franchising. Second, I survey the literature on franchising, highlighting theoretical issues and the scope of existing multi-unit franchising research. I then explore organisational design issues and criteria in franchising, before proposing a framework to theorise about organisational design choices in franchising. The framework involves the development of propositions that explore the influence of environmental and task uncertainties on franchising form choices. I then present the research objectives and questions that govern this research, before outlining the structure and content of forthcoming chapters.

### **Business Format Franchising**

The focus of this thesis is business format franchising (BFF), which accounts for nearly three-quarters of all franchise arrangements in the United States (Combs & Castrogiovanni, 1994). Typically, BFF involves the franchisor providing franchisees with a comprehensive business package including a product or service, trademark, methods of operations, and ongoing guidance (Hoffman & Preble, 1991). Well-recognised sub-sectors utilising BFF include fast-food restaurants, domestic cleaners, business services, computer equipment, real estate, convenience food stores, auto repair and a variety of other products

and services (Justis & Judd, 1986). This can be distinguished from product and trade name franchising which uses franchisees to distribute a product under a franchisor's trademark, and is common in automobile sales, retail gasoline, and soft drink distribution (Preble, 1995).

A franchise relationship involves a franchisor granting franchisees the right to operate a business format, comprising a product or service for sale to the market through satellite enterprises (Stern & Stanworth, 1994), often in particular locations (Norton, 1988b). The franchisor normally charges franchisees an initial fee for this right as well as ongoing royalties, typically a percentage of sales (Falbe & Dandridge, 1992; Norton, 1988a, 1988b; Rubin, 1978; Shane, 1996). Some also require franchisees to contribute an advertising fee to be used solely for advertising expenses (Desai, 1997). The essence of the franchise relationship is formalised in a franchise agreement, a legal document that provides legally binding obligations and duties on both franchisor and franchisee (Felstead, 1993). Franchisor's control may extend over a variety of aspects. These may include products sold, price, quality, hours of operation, conditions of the plant, inventory, insurance, personnel and accounting and auditing (Felstead, 1993; Rubin, 1978; Shane, 1996). Furthermore, the franchisee may be compelled to purchase inputs from the franchisor or from a list of approved suppliers (Norton, 1988a, 1988b; Rubin, 1978). The franchisor normally provides managerial assistance to the franchisee in areas such as site selection, store layout, promotions, an advice hotline, bookkeeping, and so on, though the actual extent of ongoing support among franchisors varies (Rubin, 1978).

The Franchise Association of New Zealand, on its Internet site, defines franchising similarly:

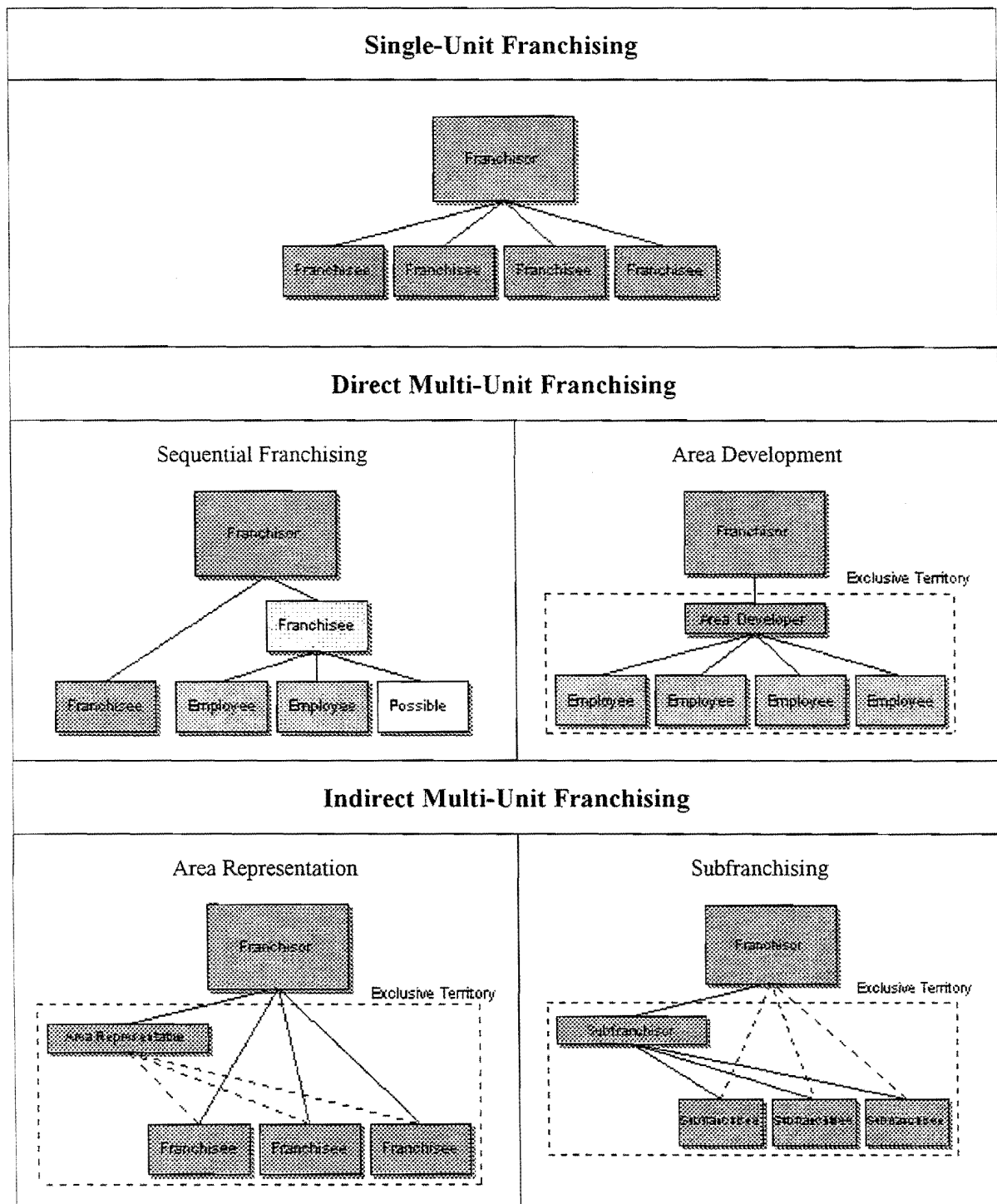
*[Franchising] (i)s a method of marketing and distribution whereby a company (called the franchisor) expands nationally or internationally by granting a person or company (called the franchisee) the right to operate a copy of its business in another geographic area. The right will usually include the ability to use the name, the business system and the know-how of the franchisor.*

*The franchisor gains his or her income from initial and ongoing fees paid by the franchisee. In return, he or she must provide a variety of services to encourage the continuing profitability and growth of the franchisee's business. The franchisee pays to set up the business in their area and is the owner of their own business. They receive their income from successfully marketing a desirable product or service under a promotable brand name.*

### **Multi-unit Franchising**

Franchise systems can consist of a variety of franchising arrangements that can be broadly grouped into two types of organisational arrangements. In *single-unit franchising* (see Figure 1), franchisees operate a single franchise outlet (Kaufmann & Dant, 1996). This is consistent with a historical image of franchising (Caves & Murphy, 1976; Curran & Stanworth, 1983; Norton, 1988b; Oxenfeldt & Kelly, 1969; Rubin, 1978). Frequently, a franchisee may own more than one outlet leading to *multi-unit franchising* forms (Baucus, Baucus & Human, 1993; Bradach, 1995, 1998; Grünhagen & Mittelstaedt, 2000; Kaufmann, 1992; Kaufmann & Dant, 1996; Kaufmann & Kim, 1995; Lafontaine & Kaufmann, 1994). For example, in the study reported by Bradach (1997), 17 people owned half of KFC's 3,592 franchise units.

**Figure 1**  
**Franchising Forms**



*Adapted from Kaufmann & Kim (1995)*



Broadly, multi-unit franchising forms can be further categorised into two groups – the *direct* and the *indirect* form. In the direct form, a high performing franchisee may be permitted to expand and purchase additional franchises on an incremental basis. This is called *sequential franchising* (Kaufmann, 1992; Kaufmann & Dant, 1996; Kaufmann & Kim, 1995). An important implication of sequential franchising is the necessity to hire employees as managers as it becomes increasingly difficult for the franchisee to maintain a direct operating role with each additional unit (Kaufmann, 1992). *Area development* involves the franchisor granting the franchisee the rights and obligation to establish and operate more than one franchised unit within a specific territory. Frequently, a development schedule will be agreed upon specifying a minimum rate of expansion and the area developer must have the financial and managerial capacity to develop the units (Lowell, 1991). Similar to sequential franchising, area development franchisees recruit employees to manage units. Both sequential franchising and area development constitute the direct form. However, the franchisor may still retain the right to establish new units through company outlets or single-unit franchising.

In the indirect form, the franchisee is granted the right to provide franchises to other parties (Lowell, 1991). This form is called *subfranchising*. A subfranchisor is responsible for regional or local issues affecting subfranchisees such as site selection, training, operating assistance and monitoring - tasks normally performed by a franchisor in the direct form (Lowell, 1991). In addition, units are more likely to be owner-operated compared to the direct forms, although in some instances subfranchisors may also be granted the right to own and operate franchises themselves (Justis & Judd, 1986; Kaufmann & Kim, 1995; Lowell, 1991). Typically, a development schedule may be specified. *Area representation* is a variation of subfranchising in which the agreement also normally involves an exclusive territory and a development schedule (Lowell, 1991). Under an *area representation* agreement the franchisor grants an area representative the right to solicit prospective franchisees. The area representative furnishes franchisees with supporting services but does not recruit subfranchisees. The type and extent of services provided by the area representative also varies and is frequently less than is provided under subfranchising agreements (Lowell, 1991). The indirect form comprises of both subfranchising and area representation agreements. Again, the franchisor will often

reserve the right to establish company-owned operations or franchises within the territory offered to subfranchisees and area representatives (Lowell, 1991).

Direct and indirect forms differ on two important aspects. First, in the indirect form, owners are more likely to manage units under subfranchising and area representation agreements. In contrast, the direct forms may have more employee-managers. Second, in the indirect form there is an additional layer of hierarchy and control between the franchisor and unit-level management. While in the indirect forms, contracts exist between the franchisor and the subfranchisor/area representatives, on the one hand, and between the franchisees and the subfranchisor/area representatives, on the other, the franchisor still retains a non-contractual interest in the behaviour of the franchisees as it can influence consumer perceptions of the entire chain and, therefore, the franchisor's brand equity. Figure 1 illustrates the direct and indirect forms. Franchise systems may comprise more than one franchising form. For example, well-known fast-food systems Pizza Hutt and McDonalds combine area developers, sequential multi-unit holders, and company-owned units, within their franchise systems (Kaufmann, 1993; Kroc, 1985; Love, 1985).

The definitions of single-unit franchising, sequential franchising, area development, area representation and subfranchising are summarised in the Table 1.1 below.

**Table 1.1**  
**Summary of Franchising Form Definitions**

<b>Franchising Form</b>	<b>Definition</b>
Single-Unit Franchising	Franchisees are restricted (by the franchisor) to operating a single franchise outlet.
Sequential Franchising	The franchisor permits certain franchisees to expand and operate additional franchises on an incremental basis. Normally, only high performing franchisees are allowed to establish additional franchise units. Additional franchise units typically have employees as managers, as it becomes increasingly difficult for the franchisee to maintain a direct operating role within each unit.

Area Development	The franchisor grants a franchisee (area developer) the rights and obligation to establish and operate more than one franchised unit within a specific territory. Frequently, a development schedule will be agreed upon specifying a minimum rate of expansion and the area developer must demonstrate the financial and managerial capacity to develop the units. Similar to sequential franchising, area development franchisees often recruit employees to manage units.
Area Representation	Under an <i>area representation</i> agreement, the franchisor grants an area representative the right to solicit prospective franchisees within a specified territory. The area representative then furnishes franchisees with supporting services but does not recruit subfranchisees. The type and extent of services provided by the area representative also varies and is frequently less than is provided under subfranchising agreements.
Subfranchising	The franchisor grants a subfranchisor the right to provide franchises to other parties (subfranchisees) within an exclusive territory. A subfranchisor is then responsible for regional or local issues affecting subfranchisees, such as site selection, training, operating assistance and monitoring. Individual franchise units are typically owner-operated, although in some instances subfranchisors may also be granted the right to own and operate franchises themselves. Typically, a development schedule will be agreed upon specifying a minimum rate of expansion.

### **Theoretical Issues in Franchising**

The franchising literature has mostly focused attention on two theoretical issues: (a) why do firms choose to franchise? and (b) why do firms operate both company-owned and franchised outlets? There are two alternative explanations for why firms choose to franchise rather than expand through company ownership. The *capital scarcity* or *resource allocation theory* argues that firms choose franchising because they lack the necessary resources for expansion (Oxenfeldt & Kelly, 1969; Hunt, 1972). The evolution of this viewpoint argues that franchising efficiently delivers resources that growing businesses require, but seldom have (Dant, 1995). These resources include (1) financial capital,

through access to franchisee funds, (2) human capital, through franchisees who are viewed as a self-selected pool of managerial talent, and (3) local market knowledge, through franchisees who contribute reliable knowledge of local market conditions to assist site selection decisions (Caves & Murphy, 1976; Dant, 1995; Hunt, 1972, 1973; Minkler, 1990; Oxenfeldt & Kelly, 1969; Ozanne & Hunt, 1971).

The second perspective, *agency theory* (Baiman, 1982, 1990; Eisenhardt, 1985, 1988, 1989b; Levinthal, 1988; Scapens, 1985) views organisational forms as arising out of the relationship between principals (franchisors) and agents (franchisees/managers). The theory invokes the principle of utility maximisation to argue that the agent will not always act in the best interests of the principal (Jensen & Meckling, 1976). Agency theory identifies two impediments to effective contractual performance: moral hazard or the lack of effort on the part of the agent and adverse selection or the misrepresentation of ability by the agent (Fama & Jensen, 1983). While agency theory has been criticised for its underlying assumptions about human behaviour and organisational processes (Donaldson, 1990), it does offer a useful framework for examining franchising relationships. It is argued that franchising facilitates the reduction of the problems associated with adverse selection and moral hazard by making the franchisee the residual claimant on the proceeds of a franchised outlet (Brickley & Dark, 1987; Combs & Ketchen, 1999; Rubin, 1978). Adverse selection is reduced, because qualified individuals are more likely to see buying a franchise as worthwhile than unqualified individuals (Shane, 1996). Shane (1996) argues that predilection exists because expected compensation from residual claimancy will fall below that of the average wage rate if the prospective franchisee is not qualified. The problem of moral hazard is reduced because franchisees, as owners of the units they operate, are more likely to perform highly. Franchisees are more motivated because they bear or receive the costs and benefits of their own actions (Brickley & Dark, 1987). By contrast, managers of company-owned units lack similar incentives to perform, because their remuneration is partly fixed salary and determined independently of unit performance (Carney & Gedajlovic, 1991).

The capital scarcity theory has been criticised on two counts. First, it is argued that franchisees are a costly source of capital compared to passive investors. This is because franchisees have a limited number of outlets and face greater risks. They are likely,

therefore, to demand greater returns (Norton, 1995; Rubin, 1990). Second, it is argued that agency theory provides a more robust explanation precluding the necessity to invoke capital scarcity arguments (Shane, 1998). However, there is indirect support for the capital scarcity theory. In one study, access to capital was cited as a reason for franchising by 60 percent of managers surveyed (Dant, 1995). There is evidence that franchising increases and falls in response to interest rate increases (Martin and Justis, 1993). This is seen as a support for the capital scarcity theory since interest rates influence the number of capital-scarce firms in an economy. Agency theory has also received empirical support. Brickley and Dark (1987) found that franchising was favoured over company ownership under conditions of high monitoring costs, low initial investment cost per unit and high frequency of repeat customers per unit. Thompson (1992) found that company ownership is favoured in urban areas and in areas where there are large number of units. Studies by Thomas, O'Hara, and Musgrave (1990) and Combs and Castrogiovanni (1994) also support agency theory arguments.

While each theory has received modest empirical support, it is likely that together they may explain why firms choose to franchise. Based on a study of 152 franchisors in the fast-food restaurant industry, Kaufmann and Dant (1996) found that the use of multi-unit franchising is positively related to growth rates. They argue that such an effect indicates that capital scarcity may be the reason for franchisors to use multi-unit franchising. This is because multi-unit franchising arrangements cannot control for shirking at the unit level. They also found that the level of commitment franchisors feel toward continuing to franchise is negatively related to the average number of units per franchisee and negatively related to their ability to obtain capital elsewhere. They conclude that this is ".... consistent with the idea that agency and capital reasons are working in concert to explain franchising" (Kaufmann & Dant, 1996: 355). Combs and Ketchen (1999) tested predictions related to firms' franchising decisions based on agency theory and capital scarcity hypothesis on a sample of 91 restaurant chains. The study found that, while the agency variables were significant predictors of franchising, the capital scarcity variables explained additional variance. They concluded: "Such a finding not only sheds light on a long-disputed aspect of franchising research but also points to the need for the application of multiple theories in studies of franchising literature" (Combs & Ketchen, 1999: 205). While both these studies are based on the fast-food industry, making generalisation to all

franchise relationships somewhat problematic, the findings do indicate the need for the use of multiple perspectives for studying organisational arrangements such as franchising. Another study (Shane & Foo, 1999) supports the use of multiple perspectives in franchising research. They examined the survival of 1292 new franchisors established in the U.S. from 1979-1996. Their study supports the use of institutional explanations in addition to economic explanations for the survival of new franchisors.

The second issue that is both puzzling and contentious in franchising is the simultaneous operation of both company-owned and franchised outlets in franchise chains. This has not received a great deal of attention. Bradach (1997) refers to this simultaneous use of company-owned and franchised outlets as the plural form. Why do franchise chains prefer the plural form given that they manifest contrasting economic and managerial characteristics? Again there are competing explanations for this puzzling phenomenon. The economic explanation is based on the use of the promotion-based incentive systems to motivate managers. It is argued that in some organisations the economies of scale associated with production are such that the corporate hierarchy is not large enough to provide promotion-based incentive systems for all lower level managers (Brown, 1998). Therefore these organisations decide to franchise since franchising provides an alternative incentive system. However, complete franchising is less optimal since the promotion-based system is more efficient. Thus, the economic model argues that dual distribution or the plural form and franchising is a long run equilibrium solution for organisation. Bradach (1997) offers an alternative organisational explanation. Based on an ethnographic field study of five large U.S. restaurant chains, he argues that the plural form enhances the performance of the chain overall by rectifying some of the weaknesses and elevating some of the strengths of the company-owned and franchise units. Specifically, he discusses four processes – modelling, ratcheting, socialisation and mutual learning – that promote uniformity and system-wide adaptation. In his study, franchisees modelled the structure and practices of company-owned units to manage their multiple units. Ratcheting involved “having each arrangement serve as a benchmark for the other on a variety of performance measures” (Bradach, 1998: 8). The socialisation process involved using company people as franchisees. Mutual learning refers to the process where the franchisees and company-owned units complemented each other in generating, testing, selecting and implementing new ideas. In the absence of any empirical support for the economic model, Bradach’s

study offers a richer explanation for the prevalence of the plural form. The most important contribution of his study is the need to view organisational design choices in franchising in terms of a balance between conflicting demands of standardisation and adaptation.

### **Multi-Unit Franchising Research**

Considering the pervasiveness and magnitude of multi-unit franchising there is a notable dearth in research examining the complex array of multi-unit forms (Grünhagen & Mittelstaedt, 2000; Kaufmann and Dant, 1998). This section summarises the findings of four key studies exploring a variety of issues relating to selected multi-unit franchising forms.

Robicheaux, Dant and Kaufmann (1994) surveyed 160 U.S. fast-food franchisors to examine the incidence and operating characteristics of multi-unit franchising. The research reported that, on average, 33 per cent of all franchisees could be characterised as multi-unit franchisees (comprising sequential and area development franchisees), and almost 20 per cent of multi-unit franchisees held area development agreements. Explaining the incidence of these forms, the study reported that area development agreements were more common in the chicken and full menu industry segment of the fast-food sector. Robicheaux et al (1994) also found that the greater respondents perceptions of franchisee and franchisor management difficulties with multi-unit operations, the lower the percentage of operators with area development agreements.

Bradach (1995) compared the effectiveness of two types of franchising forms – (1) single-unit franchising and (2) multi-unit franchising, comprising sequential franchisees and area developers only – to meet four key management challenges, namely unit growth, uniformity, local responsiveness and system-wide adaptations. Bradach addressed these issues with an in-depth field study involving semi-structured interviews with personnel from five very large and successful U.S. fast-food franchise systems. Bradach proposed and found that multi-unit franchisees facilitated more rapid unit growth by obviating the need and investment required to attract and select new franchisees for each additional unit. He also found that sequential franchising and area development facilitated system-wide adaptations, in these huge chains, because the tasks of implementing changes involved

persuading a comparatively small number of franchisees who each, in turn, own tens or potentially hundreds of units. Single-unit franchising, by contrast, would be more cumbersome logistically, and involve the franchisor convincing individual franchisees of benefits for each and every unit. On balance, Bradach felt both forms performed equally well in addressing the issue of uniformity. Finally, Bradach (1995) found that franchisor managers and franchisees felt that single-unit franchisees performed best at addressing the challenge of local responsiveness due to incentives associated with ownership and management of each unit.

Kaufmann and Kim (1995) surveyed 169 International Franchise Association members to explore growth rates associated with area development and subfranchising forms of master franchising. They proposed and found that franchisors that employed these forms of master franchising were associated with higher rates of franchise system growth.

In the final study, Kaufmann and Dant (1996) explored growth and management issues associated with multi-unit franchising. This study involved a survey of 156 franchisors in the US fast-food industry. Kaufmann and Dant found that the proportion of sequential and area development franchisees within a franchise system were positively associated with franchise system growth rates. They also found the level of franchisor commitment to franchising was negatively related to the number of outlets per franchisee, and the ability to obtain capital elsewhere. Consequently, they posited that agency and capital acquisition arguments both contribute to the existence of franchising.

In summary, few studies exploring issues relating to multi-unit franchising. In the exceptions, findings are predominately limited to franchise systems within the US fast-food sector. Furthermore, our knowledge of franchising is further limited as none of these studies examine the full complexity of forms that are known to exist.

### **Organisational Design Issues in Franchising**

In theorising about the diversity of organisational forms in franchising, I address two specific questions: (a) what factors influence the choice between single-unit and multi-unit franchising? (b) what factors influence the choice between direct and indirect forms within



multi-unit franchising? I build on the structural contingency notion that organisational design choices are driven by the need to reduce environmental and task uncertainty (Burns & Stalker, 1961; Donaldson, 1987, 1995a, 1995b; Galbraith, 1973; Lawrence & Lorsch, 1967; Thompson, 1967).

Structural contingency theorists posit that individual organisations adapt to their environment (Donaldson, 1995a). The environment is regarded as a composite of requirements that demand individual organisations to be efficient, innovative, or whatever, in order to survive and prosper (Hage and Aiken, 1970; Donaldson, 1995a). It is then argued that an individual organisation's management will adopt an organisational structure, design, or form that reflects the organisation's environment.

At the centre of each main structural contingency theory is a contingency factor, or a set of contingency factors. The theory then delineates which organisation structure is needed in order to operate effectively at each level of the contingency factor/s (Donaldson, 1995a). For example, in a seminal multi-case study Chandler (1962) argued and found that organisations that increased their level of product diversification needed to move from a functional to multi-divisional structure, to increase the level of required decentralised decision-making. He argued that the multi-divisional form best catered for high levels of product diversification, by catering for the complexity through allowing co-ordination of each separate product market. By contrast, Chandler's (1962) research also demonstrated, through rich qualitative evidence, how low organisational performance would be associated with utilising the multi-divisional structure when levels of product diversification are low.

Other studies show how varying environmental factors have led organisations to adopt differing levels of size, technology, diversification, bureaucracy, and other factors, each of which may be considered a contingency variable in structural contingency theory (e.g., Blau, 1970; Chandler, 1962; Donaldson, 1995a; Weber, 1968; Woodward, 1965).

In this thesis, I argue that organisational designs represent the decision-makers' choices in managing different aspects of environmental and task uncertainties (Stinchcombe, 1990). In other words, environmental and task dimensions or contingencies influence the choice

of organisational form. In order to map the nature of this influence, the environmental and task contingencies need to be identified and linked to specific organisational design criteria. Therefore, I first operationalise the dimensions of environmental and task uncertainty based on the extant literature in structural contingency theory. Second, I propose four design criteria based on the extant literature on franchising forms (Bradach, 1998; Kaufmann & Eroglu, 1998) and link each criterion to specific dimensions of the environment and task uncertainty.

Structural contingency theory has paid a great deal of attention to the concept of environmental uncertainty. There is a well-established literature that conceptualises environmental uncertainty in terms of three dimensions. These are *munificence* or capacity of the environment, *dynamism* or turbulence in the environment and *complexity* in terms of heterogeneity and dispersion (Aldrich, 1979; Child, 1972; Dess & Beard, 1984; Duncan, 1972; Mintzberg, 1979; Scott, 1981). I operationalise munificence as the size and growth of the market. I define demand size as total market sales for a particular product/service within a domestic economy. Demand growth refers to the change in total market sales for a particular product/service sector within a domestic economy. Accordingly, I propose demand size and demand growth as the two variables associated with munificence. I propose intensity of rivalry as a measure of environmental dynamism. Intense rivalry leads to the introduction of new products and services, calls for flexibility and adaptation and heightens uncertainty for rival organisations. Managerial efficiency becomes paramount in administering chain units. Intensity of rivalry calls for system-wide efficiency, more diligent unit-managers, clear communication, and power to make adaptations and monitor effectively on a system-wide basis. I propose demand heterogeneity and demand dispersion as measures of environmental complexity. Apart from size, growth and heterogeneity, demand may also be geographically dispersed.

Finally, in structural contingency theory, task uncertainty has been operationalised in terms of diversity of outputs, number of different input resources utilised and the level of goal difficulty (Galbraith, 1973). I argue that task uncertainty is related to the product/service features of a franchise and operationalise it in terms of product-line breadth, number of suppliers and inputs and product complexity.

## **Organisational Design Criteria in Franchising**

I contend that a franchising form must provide for four design criteria: (a) growth by adding units, (b) standardisation by ensuring uniformity, consistency and system-wide implementation of new ideas, (c) local responsiveness by responding to variations in local demand, and (d) management of task complexity.

The importance of growth as a design criterion is well established in the franchising literature. It has been shown that the use of franchising not only overcomes managerial limits to growth but also enhances firm growth and survival (Lafontaine, 1992; Kaufmann & Dant, 1996; Shane, 1996). In franchise chains, typically growth is associated with addition of new units since existing units are unable to grow beyond a certain limit imposed by their location (Bradach, 1998). Demand size and demand growth are the two key environmental variables associated with growth. The size of the total market influences the feasibility of growth. Establishing chain unit and sales growth at a rate commensurate with increases in demand is important as any lag means missed opportunities, which may result in the creation of new and/or larger competitors.

The second design criterion is standardisation. Standardisation not only reduces costs by achieving economies of scale but also reduces the cost of monitoring quality across units (Kaufmann & Eroglu, 1998). While franchising may convert franchisees into residual claimants and take care of the problem of suboptimal effort, it is unable to deal with the problem of misdirected effort (Shane, 1996). Hence, monitoring is still needed to minimise misdirected effort. Standardisation reduces the cost of monitoring by quantifying subjective properties such as quality or convenience (Kaufmann & Eroglu, 1998). Standardisation also reduces costs by minimising duplication of systems and practices. Therefore, it is directly associated with a strategy of cost minimisation. However, standardisation also affords benefits other than cost minimisation. It permits consistency of image and service (Kaufmann & Eroglu, 1998). Uniformity in terms of image and service is critical in establishing a favourable market position. Standardisation also facilitates the introduction of new products and services by providing the franchisor with better information about changes to the system and by facilitating system-wide implementation (Kaufmann & Eroglu, 1998). Intensity of rivalry is the environmental driver for standardisation. This is because competition reduces profit margins and pushes

franchisors towards greater cost savings. As markets get saturated and rivalry intensifies, cost minimisation becomes an attractive option. Standardisation helps franchisors to reduce costs.

The third design criterion is local adaptation. Local adaptation is critical when a franchise chain operates in diverse or changing markets. Meeting local requirements becomes paramount for the unit operator. However, the need for local adaptation may conflict with the franchise chain's requirement for uniformity and standardisation (Bradach, 1998; Kaufmann & Eroglu, 1998). Therefore, local adaptation needs to be balanced with standardisation. This conflict between adaptation at the local level and standardisation at the system level increases the importance of four areas of franchise system management. First, chain unit managers must be diligent in order to identify and respond to customer wants and be motivated to communicate important market information to the franchisor. Second, there must be clear communication paths for accurate and timely flows of information. Third, the franchisor must maintain bargaining power over franchisees to assist adaptation at the chain-unit level. Finally, bargaining power is also required for effective monitoring, to ensure conformity with standardised practices. Local adaptation is related to both diversity in markets and the dispersed nature of demand (Kaufmann & Eroglu, 1998). Heterogeneous demand requires unit operators to be locally responsive. Dispersed demand means chain units must be established in locations geographically removed from their franchisor. I expect demand heterogeneity to be associated with local adaptation and demand dispersion to be associated with both local adaptation and growth.

The fourth design criterion is managing task complexity. In a franchise, four features of the product/service offerings contribute to task complexity. *Product-line breadth* (PLB) refers to the number of different product types or services that chain units offer to customers; accordingly, some businesses may have a *narrow* while others have a *broad* PLB. For example, a specialist retailer may carry a smaller range of stock compared to a general retailer. *Number of suppliers* refers to the number of separate entities from whom a franchise sources products that are offered to customers. *The number of inputs* refers to the number of product inputs involved in the product/service offering. Finally, *product complexity* refers to the relative simplicity/complexity of preparing the product/service mix for customers. PLB, the number of suppliers and the number of inputs also affect

product complexity. I propose that product/service features of a franchise drive the need to manage task complexity.

These four structural requirements with their associated environmental/task dimensions are summarised in Table 1.2.

**Table 1.2**  
**Environmental & Task Dimension and Organisational Design Criteria**  
**in Franchising**

<b>Environmental/Task Dimensions Based on Structural Contingency Theory</b>		<b>Organisational Design Criteria Based on Franchising Literature</b>
Munificence operationalised as demand size & demand growth	-----	Growth
Dynamism operationalised as intensity of rivalry	-----	Standardisation
Complexity operationalised as demand heterogeneity & demand dispersion	-----	Local Adaptation
Task Complexity operationalised as product-line breadth, number of suppliers, number of inputs and product complexity	-----	Management of Task Complexity

To summarise, environmental and task contingencies influence the choice of design criteria in franchising. Given specific environmental and task contingencies, franchisors must choose an organisational form that is superior in meeting the design criterion associated with the specific environmental or task dimension. The notion of “fit” or alignment in structural contingency theory captures this idea of linking environmental/task drivers with organisational design attributes of fit (Van de Ven & Drazin, 1985). However, in this thesis I have adopted a different approach. I depart from contingency theory by including two other sources of uncertainty that are ignored by the theory.

## Choice of Organisational Form in Franchising

The central idea in contingency theory is that environmental and task uncertainties influence the design of organisational forms. However, these two sources of uncertainty do not exhaust all the sources of uncertainty that impinge on an organisation. There are other significant sources of uncertainty that impact on organisational design choices. As Stinchcombe (1990) notes, one of the most complex uncertainties facing organisations is about the ability and willingness of people to do the work. This is particularly significant in the franchising context. Franchisors face two types of uncertainty relating to the ability and willingness of people. First, franchisors face uncertainty while recruiting potential franchisees. They may be unsure about the franchisee's ability to manage the unit in the over-all interest of the chain. They need to be able to attract the right people, select the most competent, and train them adequately to ensure over-all effectiveness. Second, franchisors face uncertainty with regard to franchisees' performance. They may be unsure whether the franchisees have extended optimal effort in the over-all interest of the chain. They need to motivate, monitor and manage the franchisees to ensure the over-all effectiveness of the chain.

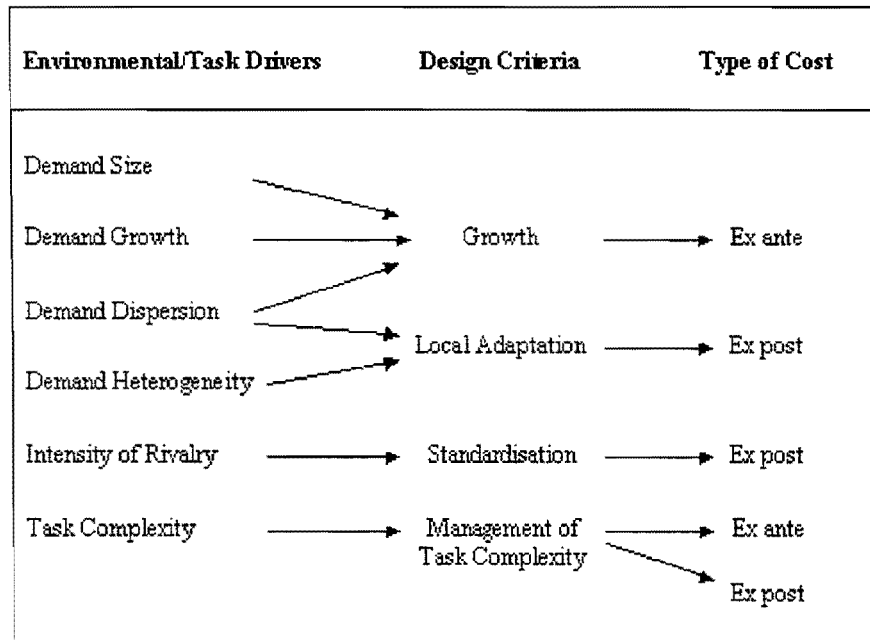
These uncertainties impose significant costs on the franchisor. Using transaction costs economics terminology, I refer to them as *ex ante* and *ex post* costs. *Ex ante* costs refer to the costs associated with attracting, selecting, training, and establishing franchisees. *Ex post* costs refer to the costs associated with motivating, managing, monitoring franchisees and also ensuring conformity of franchisees with standardised practices. Alternatively, the two types of uncertainties can also be conceptualised within an agency theory framework. The first type of uncertainty that relates to franchisee recruitment and ability is a problem of adverse selection or hidden information while the second type of uncertainty relating to franchisee willingness is a problem of moral hazard or hidden effort (Arrow, 1985; Bergen, Dutta & Walker, 1992).

Agency theory and transaction costs economics have both commonalities and differences. They both emphasise a managerial discretion set-up and efficient contracting but differ with respect to unit of analysis, focal cost concern and contractual focus (Williamson, 1988). I contend that *ex ante* and *ex post* costs can be analysed using an agency theory framework. I support this argument by showing how *ex post* costs can be viewed in

agency theory terms. *Ex post* costs are made up of two components – motivational costs, that is, the costs of motivating unit managers and standardisation costs, which are costs associated with ensuring uniformity and adaptation of standardised practices. The motivational problems are reduced to a great extent by making franchisees residual claimants. In accordance with agency theory, I expect franchisees or owner-operators to be more motivated than employee-managers in ensuring optimal performance of their units. Therefore, I expect franchisors to incur lower costs in motivating owner-operators compared to employee-managers. Indirect forms have more owner-operators than employee-managers in comparison with the direct forms. Therefore, I expect indirect forms to be associated with lower motivational costs. On the other hand, centralisation of decisions about uniform practices tends to reduce standardisation costs. When decision-making is delegated, as in indirect forms, I expect standardisation costs to be higher due to duplication of systems and procedures. Therefore, I expect indirect forms to have relatively higher standardisation costs compared to the direct forms.

Each design criterion emphasises one type of cost over the other. In the following section, I show that *ex ante* costs are associated with growth. Standardisation and local responsiveness require greater attention to *ex post* costs. Task complexity is associated with both *ex ante* and *ex post* costs. Figure 2 summarises my arguments.

**Figure 2**  
**Relationship between Environmental/Task Factors,**  
**Design Criteria and Transaction Costs**



Franchising forms differ in their ability to mitigate these costs. Therefore, comparison of costs offers a way to choose an optimal structure. More importantly, analysing these two uncertainties in terms of transaction costs is a useful way to unpack the notion of fit that is central to structural contingency theory. I analyse fit in terms of transaction costs and choose the form that minimises these costs. In the following sections, I consider each of the environmental and task contingencies and analyse their impact on single and multi-unit franchising in the first instance in terms of transaction costs. Subsequently, I compare direct and indirect forms within multi-unit franchising in terms these *ex ante* and *ex post* costs.

### **Influence of Environmental uncertainty**

#### *Munificence*

Demand size and demand growth constitute munificence. Both demand size and demand growth require the design to emphasise growth. *Ex ante* costs are crucial in assessing designs for growth. Higher demand size requires more units to be established and



managed imposing significant capital requirements and managerial burden on the franchisor. While the single-unit form provides the franchisor with direct control and, therefore, lowers *ex post* costs, multi-unit franchising enables the franchisor to economise on *ex ante* costs. This is not without disadvantages: owner involvement in units is reduced (Kaufmann, 1992) and franchisees acquire bargaining power with additional units (Kaufmann & Lafontaine, 1994; Lowell, 1991). However, franchisors may be willing to trade-off control for lower *ex ante* costs. Therefore, I propose:

*Proposition One: When demand size is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.*

Given that multi-unit forms will be more prevalent, how does a franchisor choose between a direct and an indirect form? Both forms will lower *ex ante* costs compared to the single-unit franchising form; therefore I need to compare the motivational and standardisation cost components of the *ex post* costs. A direct form will have more employee-managers compared to an indirect form. Therefore, indirect forms with owner-operators will minimise motivational, but will compromise standardisation costs by duplicating the franchisors' role through master franchisees. On the other hand, direct forms minimise standardisation costs by providing franchisor support directly but jeopardise motivational costs through having more employee-managers. The franchisor is left to choose between faster growth through lower motivational costs in the indirect forms and advantages of greater standardisation in the direct forms. Therefore, the choice between direct and indirect forms is influenced by the franchisor's preference for standardisation versus rapid growth. Therefore, I propose:

*Proposition Two: When demand size is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.*

Single-unit franchising has lower growth potential because franchisors recruit, train and socialise new franchisees for each additional franchised unit. In other words, the *ex ante* costs of this form are high. Through enabling existing franchisees to expand, I anticipate multi-unit forms to yield greater growth prospects, while also economising on franchisor

resources. In terms of sales growth at the outlet level, however, I expect single-unit franchising to perform best. Direct multi-unit forms involve decreasing owner involvement, and hence productivity, in individual units. I expect that while sales growth per individual unit is compromised, these multi-unit forms provide greater potential for growth in the number of units, leading to larger overall growth. Indirect forms are also likely to enable faster growth in units as franchisors focus scarce resources on recruiting and training master franchisees that, in turn, establish and support multiple units within specified territories. Thus, with the recruitment of several master franchisees, these forms enable the simultaneous development of units in multiple markets/territories. In terms of sales growth at the unit level these forms should perform similar to the single-unit form since they preserve owner-involvement at the unit-level. In summary, I propose the following:

*Proposition Three: When demand growth is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.*

The strategic choice between standardisation and faster growth will mediate the choice between direct and indirect multi-unit forms. Sequential franchising and area development attempt to achieve growth while preserving cost efficiencies through centralising franchisor support. However, they compromise unit-level growth by reducing owner-involvement in unit-level operations. Conversely, area representation and subfranchising preserve owner involvement to maximise output at the unit level. However, by duplicating the franchisor's role in different markets using master franchisees, they compromise standardisation costs. Hence, I propose the following:

*Proposition Four: When demand growth is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.*

#### *Complexity*

I operationalise complexity as demand heterogeneity and demand dispersion. Demand heterogeneity imposes conflicting demands on the franchisor. On the one hand, units need to be responsive to local demand. This may require units to adopt different practices and

will, therefore, be in conflict with the system's requirement for standardised practices. The franchisor needs to balance the conflicting demands of standardisation and local responsiveness. Both standardisation and local adaptation are related to *ex post* costs. Therefore, under conditions of heterogeneous demand, *ex post* costs become crucial. In keeping with agency theory, I expect that owner-managers will be more diligent and therefore more motivated than employee-managers to identify and respond to different customer requirements and pass information on to the franchisor. Accordingly, I propose single-unit franchising will perform well in this regard. This receives some empirical support from Bradach's (1998) five-chain study, where he notes multi-unit franchisees providing fewer ideas compared to hands-on owner operators. The power each form provides the franchisor to effectively make adaptations and monitor chain units becomes increasingly important with heterogeneous demand. Single-unit franchising provides the most appropriate form because franchisor's power to make changes is reduced in multi-unit forms (Kaufmann & Lafontaine, 1994; Lowell, 1991). In indirect forms such as area representation and subfranchising, unit management diligence should be similar to single-unit franchising, as each form is likely to have owner-managers. However, area representation and subfranchising are likely to reduce the effectiveness of adaptations and monitoring since they compromise standardisation costs. Therefore, I suggest:

*Proposition Five: When demand heterogeneity is high, the single-unit franchising form will be more prevalent compared to multi-unit forms.*

Demand dispersion requires the establishment and management of geographically isolated outlets. Therefore, both *ex ante* and *ex post* costs may be important. *Ex ante* costs are highest with single-unit franchising where new franchisees are recruited for each unit. Direct multi-unit forms economise on these costs. Sequential franchising enables the franchisor to economise on these costs through expanding existing high performing, established and experienced franchisees. Granting an exclusive territory for multiple units from the outset, as in area development, lowers *ex ante* costs further.

When demand is dispersed, *ex post* costs are also crucial. A number of studies (Brickley & Dark, 1987; Brickley, Dark & Weisbach, 1991; Norton, 1988a) proposed and found that the proportion of franchisee-owned units to company-owned units is greater with distance

from franchisor headquarters. They concluded that employee-managers need more monitoring for sub-optimal effort than franchisees because they do not have residual claims tied to the performance of their unit. Following this, I expect sequential franchising and area development will incur greater *ex post* costs, since they have employee-managers who require supervision for sub-optimal *and* misdirected effort. In terms of *ex post* costs, I expect the prevalence of single-unit franchising to be higher with high demand dispersion.

Compared to single-unit franchising, indirect forms such as area representation and subfranchising reduce *ex ante* franchising costs as master franchisees under each arrangement undertake activities normally performed by the franchisor. Subfranchising reduces these costs most since franchisors delegate more responsibilities with this form. They also reduce *ex post* costs. An area representative may, and a subfranchisor almost certainly will, be granted tasks associated with monitoring franchisees within their territory. These forms, and especially subfranchising, are also likely to reduce costs normally associated with the franchisor performing such tasks. Therefore, I expect that area representation and subfranchising will be more likely to be adopted with dispersed demand.

In summary, with high dispersion of demand, both *ex ante* and *ex post* costs point to increased prevalence of indirect forms such as area representation and subfranchising. In terms of *ex ante* costs, I expect the increased prevalence of direct forms such as sequential franchising and area development. However, the opposite appears to be true in terms of *ex post* costs. I expect that the savings from *ex ante* costs will be greater than additional costs of monitoring that will increase the *ex post* costs. Thus, I propose the following:

*Proposition Six: When demand dispersion is high, multi-unit forms will be more prevalent compared to the single-unit form.*

*Proposition Seven: When demand dispersion is high, indirect multi-unit forms will be more prevalent compared to direct multi-unit forms.*

### *Dynamism*

I operationalise dynamism as intensity of rivalry. Intensity of rivalry requires the structure to be competitive in terms of being efficient, maintaining uniformity, introducing new products and services and facilitating system-wide adaptation. Therefore, standardisation is the crucial structural requirement associated with rivalry. Standardisation is directly related to *ex post* costs. Therefore, intense rivalry increases the importance of *ex post* costs. I expect single-unit franchising to provide more diligent management than direct forms such as sequential franchising and area development since owners are more likely to be managers. I also expect sequential franchising to be better than area development since area development is likely to result in a greater prevalence of employee-managers. Single-unit franchising is also less likely to result in the delay, distortion, exclusion or loss of important market information than sequential franchising and area development. This is because franchisees are more likely to report directly to the franchisor. Multi-unit forms such as sequential franchising and area development are likely to be less effective in communicating as employee managers first communicate with the franchisee who passes the information to the franchisor. Thus, potential for delay, distortion, exclusion or loss of important information is increased (Stern & El Ansery, 1977). Furthermore, franchisor power for influencing and monitoring system-wide adaptations is likely to be lower with sequential franchising and area development (Kaufmann & Lafontaine, 1994; Lowell, 1991), and I expect area development to reduce this power the most. Thus, these two are likely to impede both the speed and quality of chain unit adaptations. Therefore, the single-unit franchising form has lower *ex post* franchising costs compared to the direct forms such as sequential franchising and area development. Inefficiencies are likely to be greatest in area development with a higher proportion of employee managers.

Like single-unit franchising, indirect forms such as area representation and subfranchising are likely to provide diligent owners as managers. Franchisor power for influencing and monitoring system-wide adaptations, however, is likely to be lower with area representation and subfranchising, and I expect subfranchising to reduce this power the most. Thus, these two are also likely to impede both the speed and quality of chain unit adaptations. Compared to single-unit franchising, standardisation costs are higher in area representation and subfranchising through additional hierarchy. Inefficiencies in this area are likely to be greatest with subfranchising because subfranchisors are delegated higher

levels of responsibility compared to area representatives. In conclusion, I propose the following:

*Proposition Eight: When intensity of rivalry is high, single-unit franchising will be more prevalent compared to the multi-unit forms.*

### **Influence of Task Uncertainty**

The remaining four factors that can influence the choice of a franchise form are product-line breadth, number of suppliers, number of inputs and product complexity. Different levels of each factor impact on the complexity of unit-management. The more complex the task, the harder it is to find competent operators for the units. High task complexity requires greater emphasis on recruiting unit-managers, unit management decision-making, ensuring the quality of training and support, providing clear communication, and monitoring quality. Therefore, task complexity requires attention to both *ex ante* and *ex post* costs. With increasing task complexity, quality of decision-making, the quality of training and support and the quality of monitoring the franchise holders and unit managers become paramount. *Ex ante* costs will be higher due to the difficulties associated with attracting and selecting high-quality unit-managers. However, hiring high quality unit-managers will reduce *ex post* costs because they are likely to make high quality decisions, need less training, monitoring and support.

*Ex ante* costs will be lowest with single-unit franchising. The quality of individuals recruited will also be highest with single-unit franchising because the franchisor individually recruits and forms contracts with owner-managers. In contrast, in direct multi-unit forms, sequential franchisees and area developers are more likely to recruit employees as managers, increasing the risks of poor selection. This risk is greater with area development due to the exclusive rights to multiple outlets units from the outset. Also, single-unit franchising is less likely to result in the delay, distortion, exclusion or loss of important market information compared to both sequential franchising and area development.

Compared to single-unit franchising, I also expect indirect forms such as area representation and subfranchising to have higher *ex post* costs, due to the relative levels of responsibilities delegated to intermediaries. I expect recruitment quality to be poorest with subfranchising, since the franchisor has less involvement in this process. Compared to single-unit franchising, I expect area representation and subfranchising to compromise the quality of training and support. This is, again, due to the increasing responsibilities delegated to area representatives and subfranchisors. The quality of monitoring is also likely to decrease with area representation and subfranchising as monitoring is delegated to master franchisees. My analysis suggests the following proposition:

*Proposition Nine: When task complexity is high, the single-unit franchising form will be more prevalent compared to the multi-unit forms.*

### **Research Objectives and Questions**

The objective of this research is to determine what factors influence the choice of franchising forms. Accordingly, two research questions address this objective and guide the research:

1. Do environmental and task uncertainties influence the choice of franchising forms?
2. What other factors influence the choice of franchising forms?

The conceptual model presented in this chapter drives the first research question. Accordingly, my goal for this research is to test the logic and direction of my propositions. Specifically, I seek to determine whether, as predicted, demand size, growth, dispersion and heterogeneity, intensity of rivalry and task complexity influence the choice of franchising forms. The second research question is more circumspect and seeks to identify and explain other important factors that influence decisions pertaining to the selection of franchising forms.

While addressing the research objective and questions outlined above, it is important to note the following important limitation of scope associated with this study. This thesis focuses on what factors influence local franchisors choice of franchising forms within a

domestic context. Consequently, the research does not examine factors which influence local franchisors choice of franchising forms for use within other countries, nor does it exam factors that influence foreign franchisors choice of franchising forms for use within the local domestic market.

### **Thesis Structure**

This chapter began describing the ubiquitous nature of franchising and multi-unit franchising. It then explored theoretical issues in franchising and the current scope of research addressing multi-unit franchising. Organisational design issues and criteria specific to franchising were subsequently considered. An examination of the choice of organisational forms in franchising then followed. That examination involved the development of a conceptual model, including propositions exploring the influence of environmental and task uncertainties on choice of franchising form. Chapter 1 then concluded by stating the research objectives and questions governing this research.

The remaining thesis structure is organised as follows. Chapter 2 outlines and describes the methodology utilised in this research. The methodology chapter contains information on case study research, the preliminary study, case and informant selection, data collection and analysis, validity and reliability, and limitations. Chapters 3, 4 & 5 then follow, introducing case descriptions of franchise systems utilising single-unit franchising, direct multi-unit franchising and indirect multi-unit franchising forms, respectively.

Chapter 6 presents the analysis and findings generated from this research. It draws on case descriptions from the three preceding chapters to test the influence of environmental and task uncertainties on choice of franchising form. The chapter then illuminates and discusses a range of additional factors. These additional factors include individual and firm specific variables shown to influence form choice. Chapter 6 concludes with an overview that more clearly illustrates the variety of factors that influence specific decisions between alternative franchising forms.

The final chapter, Chapter 7, restates the key findings from this research. It then discusses these findings in the context of current research, before exploring the implications for both



franchising and organisational theory, and practitioners. Chapter 7 concludes with future research suggestions.

## **CHAPTER 2**

### **METHODOLOGY**

#### **Introduction**

This chapter outlines the case study methodology used in this research. I begin by restating the research objectives and questions governing the study, before defining and discussing the selection of a case study research strategy. Following this, I explain the research design. This covers details of a preliminary study undertaken, the unit of analysis for individual cases, case selection, choice of informants, data collection and data analysis. I then conclude the chapter by discussing validity and reliability issues, and limitations, associated with my approach.

#### **Multi-Case Study Approach**

In keeping with my research objective and research questions I adopt a case study approach. As stated at the end of the previous chapter, the primary objective for this research is to determine what factors influence the selection of franchising forms. Accordingly, my research questions seek to determine (1) whether environmental and task uncertainties influence the choice of franchising forms, and (2), what other factors influence the choice of franchising forms.

A case study methodology is appropriate to this research because I seek to describe, generate and test theory (Bryman, 1989; Eisenhardt, 1989a; Merriam, 1998; Stake, 1994; Yin, 1994). A case study approach is also advantageous for a number of other reasons. First, it allows for important contextual conditions that may be highly pertinent to the selection and utilisation of alternative franchising forms (Bryman, 1989; Eisenhardt, 1989a; Stake, 1994; Yin, 1994). It allows the investigation to retain the holistic and meaningful characteristics of real-life events (Yin, 1994) by focusing on understanding the dynamics present within single settings (Eisenhardt, 1989a).

A second important reason for adopting a case study approach is its unique ability to deal with a full variety of evidence, that includes interviews, questionnaires, secondary data

and observations (Bryman, 1989; Eisenhardt, 1989a; Stake, 1994; Yin, 1981, 1994). Finally, the closeness to detail and familiarity with ongoing organisations that this type of approach provides, can often prove more attractive to practising managers, than the abstract variables characterised by much quantitative research (Bryman, 1989).

Case study research can involve the investigation of one or many cases. I adopt a multi-case or *collective case study* (Stake, 1994). By examining several cases, I seek to achieve both a better understanding and better theorising about the phenomenon of interest than would be achievable from a single case (Merriam, 1998; Stake, 1994). Moreover, the reasons for adding cases (hence multi-case) are twofold: the generalisability of the research is enhanced and the opportunity for comparisons allows the special features of cases to be identified more readily (Bryman, 1989; Eisenhardt, 1989a; Huberman & Miles, 1994; Merriam, 1998; Miles & Huberman, 1984; Stake, 1994; Yin, 1994).

Over the years, case study methodology has been subject to three common criticisms and perceived weaknesses. The most significant criticism relates to what Yin (1994, p. 9) describes as a “lack of rigor,” with roots where “the case study investigator has been sloppy and has allowed equivocal evidence or biased views to influence the direction of findings and conclusions.” Following Yin (1994) I seek to overcome this criticism through the development, and adherence to, a thoughtfully formulated and structured research design. A second criticism relates to the generalisability of findings (Bryman, 1989; Yin 1994), and a common misconception starting with the failure to appreciate what Yin (1994, p.30) describes as “analytic generalisation,” as distinct from the more traditional “statistical generalisation.” Whereas statistical generalisation seeks inferences to a larger population on the basis of empirical data collected about a sample, the purpose of analytic generalisation is to expand and generalise to theories (Eisenhardt, 1989a; Yin, 1994). More specifically, the method of generalisation using multiple cases is analytic generalisation, where previous theory is used as a template with which to compare the empirical results of the case study. If two or more cases are shown to support the same theory, then replication may be claimed. The third area of concern relates to the length of time case studies take to prepare, and the ensuing formulation of enormous, unreadable documents (e.g. Miles, 1979). Again following Yin (1981, 1994), I attempted to avoid this pitfall through the development of a clear conceptual framework. A thorough

understanding of these concerns and criticisms are clearly important, not only to defend the methodology chosen, but also to ensure that each is countered, as much as practicable.

### **Preliminary Study**

Preliminary interviews were undertaken prior to the multi-case study in order to obtain a broader understanding of the issues surrounding the utilisation and choice of franchising forms within the New Zealand franchise market. As Yin (1994) notes, a good grasp of the issues being studied helps keep you on target, particularly during the data collection stage. Seven loosely structured interviews were conducted with a heterogeneous sample comprising a specialist franchise consultant, franchise lawyer, franchise magazine publisher, franchise banker and three franchisors. Interviewees were selected for their knowledge and experience of franchising in New Zealand. All were past or present board members of the New Zealand Franchise Association (NZFA). The sample also included the present and immediate past chairman of that association. In the absence of other signals or indicators, it seemed logical that individuals holding NZFA board positions would be knowledgeable about franchising in New Zealand.

Interviewees were questioned about their knowledge of different types of franchising and asked to identify New Zealand-founded examples of each type. Interviewees were then asked to: 1) identify what factors contribute to franchising form choice, and 2) explain how these factors influence franchising form choice. Interviews ranged from 40 to 120 minutes. All interviews were recorded and transcribed verbatim. Transcripts were then content analysed and coded on a sentence-by-sentence basis. I then reviewed the transcripts for recurrent themes and patterns (Miles & Huberman, 1984; Yin, 1994).

The preliminary interviews provided important insights. The interviews improved my knowledge of the prevalence of franchising forms in New Zealand. Valuable insights also included an increased awareness of the factors influencing franchising form choice, and how this occurs. The factors identified corresponded with many of those in the conceptual model, but also included additional factors that were not, such as a desire for growth and control, and incentives. These insights assisted numerous areas of the thesis. For example, new insights strengthened the conceptual model by confirming the importance of many

factors, and highlighting gaps in the logic underlying certain propositions. Insights assisted case selection by identifying the forms of several New Zealand-founded franchise systems. A more in-depth understanding also assisted data collection by improving my interviewing technique and ability to keep interviews on track. Finally, data analysis was assisted through an advanced awareness and understanding of potential factors and relationships.

This thesis was assisted further from insights gained from another research project I led (Floyd & Fenwick, 1999). Using a multi-case study methodology, the research project explored the problems and challenges experienced by franchisors attempting to expand their franchise systems. The research involved 10 franchisors from five different business sectors. Evidence collected for that research included the type of franchising form utilised. This research benefited from me revisiting that evidence in the context of this thesis's objectives. The evidence provided me with further background knowledge and three cases to approach for the current project.

Finally, participating in New Zealand Franchise Association (NZFA) events further improved my understanding of New Zealand franchising. From 1996 through 2000 I attended several regional NZFA breakfast and lunch meetings, three-day nationwide conferences and franchise expositions.

## **Research Design**

### *Unit of Analysis*

The unit of analysis selected to satisfy the research objectives and propositions is the franchising form within a single franchise system. Thus, a particular franchising form utilised in a single franchise system constitutes one case.

### *Case Selection*

Careful case selection is acknowledged to be of critical importance in case study research (Eisenhardt, 1989a; Miles & Huberman, 1984; Stake, 1994; Yin, 1994). This is because our ability to understand the phenomena is dependent on choosing well. Cases were

selected for theoretical reasons rather than statistical reasons (Bryman, 1988; Eisenhardt, 1989a; Glaser and Strauss, 1967; Lincoln & Guba, 1985). Cases were chosen to fill the three different categories of franchising forms outlined in the conceptual model: single-unit, direct multi-unit and indirect multi-unit franchising. Thus, the sample was selected to extend theory to a broad range of organisations and forms (Eisenhardt, 1989a). Multiple cases within categories also allowed findings to be replicated within categories (Eisenhardt, 1989a).

In total seven cases were selected. This total corresponded nicely with Eisenhardt's (1989a, p. 545) recommendations that "with fewer than 4 cases it is often difficult to generate theory... with more than 10 cases it quickly becomes more difficult to cope with the complexity and the volume of the data."

Four important criteria were identified a priori to guide case selection. The first criterion required cases provide an accurate representation of the three primary categories of form. Additionally, good matches were also sought for the different forms that make up both direct (i.e., sequential franchising and area development) and indirect (area representation and subfranchising) multi-unit franchising forms. The second criterion limited cases to New Zealand founded franchise systems. International systems with local operations were excluded in an attempt to limit extraneous variation (Eisenhardt, 1989a).

The third criterion limited the sample to mature firms. Mature firms were selected for two important reasons. First, I wanted to ensure the firm and form combinations studied were viable. Like Bradach (1992: 38) "I did not want my findings confounded by data from chains that were fads or who had not demonstrated viable organisational arrangements." Second, I wanted informants who were experienced and knowledgeable of the challenges associated with managing their business and franchise network under a range of trading conditions. Looking to the sample (Table 2 below), the majority (5/7) had ten or more years franchising experience. Further, six from seven were leaders, in terms of number of units, in their respective sectors, and, three had won important Franchise Association of New Zealand awards. The fourth and final criterion required cases to provide sufficient access to information. This meant informants needed to be available who were both willing and knowledgeable of (and preferably, influential in) their organisation's form

decision-making process.

All franchising forms were confirmed in telephone conversations. These were often lengthy. Most informants were unaware of one or more forms. Further, most informants applied different labels to the same forms. Consequently, I often needed to provide a full explanation of the various forms, and much questioning was required, to determine the form/s utilised within a particular firm. The task of satisfying this criterion was also challenging as pure or perfect examples of form appeared rare in mature franchise systems. Often, for example, two or more forms were present, or firms were changing from one form to another. Further challenge existed due to the apparent scarcity of two forms, area representation and area development, in New Zealand-founded franchise systems. The sampling process attempted to overcome these difficulties and find the best possible fit between theory and practice. The selection of individual cases (see Table 2 below) and their representation of particular franchising forms are described subsequently.

**Table 2**  
**Case Companies**

Company	Area of Business	Form	Age (years)	Years Franchising	Franchise Units
MortCo	Mortgage broking services	Single-unit franchising	9	2	27
SportCo	Sports equipment retail	Single-unit franchising	36	16	50
VideoCo	Video hire	Sequential franchising	10	10	88
RealCo	Residential real estate sales	Sequential franchising Area development	112	10	145
SnackCo	Locatable snack trays. Honesty box system	Converting from single-unit franchising to area representation	9	8	36
ServCo	Home services	Subfranchising	11	10	550+
FastCo	Courier services	Subfranchising	17	16	350+

MortCo and SportCo were selected to represent **single-unit franchising**. MortCo closely characterises a pure single-unit form. With 27 franchises there was one exception: in one agreement two partners were allowed to operate as Mortgage Consultants. With 43 of 50 stores operated by owner-operators, SportCo also closely characterises a single-unit form. However, two exceptions were noted. Two separate franchisees own two stores each. Further, another franchisee owned one store outright and had shares in two others. That franchisee, and a separate franchisee partner for each store jointly owned those two further stores. Despite these differences, SportCo satisfied my conceptualisation of single-unit franchising for at least three reasons. First, the single-unit franchising form dominated. Pure owner-operators operated 43 stores and the remaining stores maintained high levels of owner-involvement. Second, SportCo were committed to continuing with the single-unit form. SportCo considered owner-involvement to be highly important. Third, and finally, no future franchisees would be allowed to wholly purchase and operate additional SportCo franchises.

VideoCo and RealCo represent **direct multi-unit franchising**. Both firms provided good examples of this category. At VideoCo, 20 percent of units were controlled by multi-unit franchisees while at RealCo the figure exceeded 50 percent. However, while these firms



provided a good representation of direct multi-unit franchising generally, difficulties arose in finding a pure representation of the area development form. Moreover, it appeared New Zealand-founded franchise systems rarely used area development at all in the domestic market. After much research and consideration, RealCo was selected to represent this form. At least two limitations should be noted, however. First, RealCo also utilised sequential franchising. Second, the operation of area development at RealCo was on a small scale. While the definition of area development conjures images of area development franchisees with large numbers of units, RealCo area developers had between two and five offices. Despite these limitations, I felt both firms provided a good representation of direct multi-unit franchising forms generally. Further, with both utilising sequential franchising, and one also adopting area development, useful comparisons could be made within this category.

ServCo, FastCo and SnackCo represented **indirect multi-unit forms**. Of these, ServCo and FastCo provided examples of subfranchising while SnackCo represented area representation. While good examples of subfranchising were identified, no working example of area representation could be found. Finally, after much research, I identified SnackCo advertising for franchisees characteristic of area representatives. Ironically, this franchise system was founded and managed by a franchisor interviewed in the preliminary study. Importantly, while SnackCo was committed to adopting area representation (from single-unit franchising), I could not find a working example. Consequently, SnackCo was not experienced with area representation. Despite that lack of operational experience, I felt that the inclusion of SnackCo to represent area representation was warranted for at least three reasons. First, no working example could be found. Second, because SnackCo was committed to utilising the area representation form, I would be able to solicit the factors leading to that decision. Finally, the newness of SnackCo's transition provided certain advantages. Specifically, the factors leading to the decision were more likely to be fresh in informants' minds. In addition, the absence of experience utilising that form limited potential bias through post hoc rationalisation.

#### *Choice of Informants*

As described in the following section, interviews provided the primary source of case information. Given the primacy of interview data in this case, selecting key informants

was critical to satisfying my research objectives (Yin, 1994). To obtain a rich and balanced understanding of each case, a cross-section of informants were selected from within each firm. Respondents were sought from the franchisor and franchisee level. Consistent with my research objectives, the founders or owners of the franchisor constituted the primary informants in the investigation. It seemed logical that these respondents would be most knowledgeable about the factors influencing decisions pertaining to form (Bogdon & Biklen, 1992). In one case, however, a founder/owner was not available. Fortunately, the franchisor executive alternative was both experienced and influential in the form decision-making process, and able to provide necessary information and insight. One or more senior executive/s were also selected to supplement these interviews at the franchisor level. Only in one case was this requirement relaxed. At SnackCo, a knowledgeable second informant was not available. Fortunately, limitations that might otherwise have appeared were minimised by the depth of information provided by the founder.

Franchisees were included in the research for a number of reasons. First, because of the interdependent nature of a franchise relationship, including the franchisees' perspective is critical to obtaining a rich and balanced understanding of the case. As indicated later in the RealCo case, the franchisees' perspective and influence can feature prominently in franchisor decision-making pertaining to form choice. Second, franchisees were able to provide important detail on unit-operation. While many franchisor informants had managed a unit at one point in time, practising franchisees were able to provide important detail on operating within their area.

In summary, involving multiple informants at the franchisor level and franchisees enabled a richer and more balanced understanding of each case to be achieved, and provided one method for ensuring the reliability and validity of findings (Jick, 1979)

#### *Access to Cases and Informants*

All the firms selected agreed to participate in the research. Initial contact involved the founder or most significant franchisor executive in all cases. Telephone conversations

were used primarily to assess their interest in participating in the research. All agreed to participate. Primary informants were then asked to recommend a secondary informant from their franchisor executive team. All except one were also available for interviewing. For franchisee informants, I requested the contact details of the franchisee (or subfranchisor and subfranchisee, in subfranchising systems) located closest to my home in Christchurch. The reason for this request was to reduce the potential for bias that might be associated with franchisors selecting their preferred choices. All were happy to provide these details and all franchisees contacted agreed to participate in the research.

Three strategies were employed to placate possible confidentiality-related concerns. First, descriptive identities, such as SportCo and VideoCo, were developed to replace the trading names of participating companies. Second, job titles rather than individual names were used in the final presentation of the data. Third, and finally, complete transcribed transcripts remained private between the interviewer and interviewee. All participants were comfortable with these arrangements.

### **Data Collection**

Case evidence was drawn from three sources: interviews, documentation and direct observations. Of these, interviews provided the primary source of case evidence.

A semi-structured format was selected for interviews. These interviews were conducted in a one-on-one manner (Creswell, 1994). This methodology was selected as the most appropriate way to collect data for two reasons. First, it was the only appropriate method for collecting data, given the factors leading franchisors to select between alternative franchising forms had not been documented (Eisenhardt, 1989a; Miles & Huberman, 1984; Yin, 1994). Second, the use of semi-structured interviews allowed for the inclusion of variables not considered when entering the field (Merriam, 1998; Miles & Huberman, 1984; Yin, 1994). Interview schedules were carefully constructed to obtain as much rich information as possible whilst retaining a focus on the research questions. Consideration of the objectives along with the diversity within cases meant different schedules were developed for franchisor and franchisee informants. Additionally, in the case of franchisor informants, further variations in schedules were sometimes required due to differences in

interviewees' area of expertise and level of experience. Variations were designed to reflect the different capabilities and limitations of each group to provide pertinent case information. Customisation meant a broader and more balanced understanding of each case could be obtained.

A general interview schedule was pre-tested twice prior to interviewing case subjects. The initial interview pre-test took place within the University. This involved me interviewing one thesis supervisor while the other observed. Following useful comments, one supervisor interviewed the other to further illustrate improvements to interviewing style and technique. For the second pre-test I interviewed the founder of a pizza delivery company. Because this company was not included in the case study I was able to talk openly with him about the research's objectives and ways in which interviews could be improved.

Initial franchisor questions focused on the historical and future development of franchising form. Following this, questions sought information on environmental and task uncertainties, and how these might be associated with business operations and franchising form. An example of that interview schedule appears in Appendix One. Franchisee questions focused more specifically on franchising form from their perspective, and on the association between environmental and task uncertainties as they affect their business operations. An example of the franchisee interview guide appears in Appendix Two.

I also made use of visual aids during franchisor interviews. These aids included representations of single-unit franchising, sequential franchising, area development, area representation and subfranchising. They mirrored Figure 1, and were enlarged onto an A3 sheet of paper.

During the interviews, I took care not to reveal the nature of propositions outlined in the conceptual model. However, effort was made to solicit information about issues that were not covered more spontaneously, and to reflect answers back to respondents to ensure the meanings conveyed were understood by both interviewer and interviewee (Bogdan & Taylor, 1989).

Franchisor interviews ranged from one to two and a half hours. Franchisee interviews were typically shorter, averaging one hour. A number of informants were interviewed more than once and in many instances I called to clarify certain points or solicit information not covered more fully in the interview/s. Specific to cases, 29 interviews were conducted involving 21 people during 1998 and 1999. Informants included twelve franchise executives and nine master or unit-level franchisees. These 29 interviews and further interactions were in addition to the seven preliminary interviews undertaken prior to the main data collection period. Consequently, 36 interviews were conducted in all. In addition to these interviews, numerous less formal interactions took place, such as conversations at franchise meetings and conferences, and telephone calls. These less formal interactions also often provided important case evidence that were considered in the analysis.

All interviews were taped with consent, and the researcher judged the interviewees to be at ease with this arrangement. Transcripts were prepared immediately following each interview (See Appendix Three for an 10 page interview snapshot). The majority of material was recorded verbatim. Only material of obvious irrelevance was omitted. On average, a one-hour interview equated to around 15 pages of single-spaced text and took between five and eight hours to transcribe.

Multiple forms of documentation were also collected and referred to as case evidence (Creswell, 1994; Eisenhardt, 1989a; Patton, 1987; Yin, 1994). Documentation considered was varied and included franchise manuals and agreements, company Intranet and Internet sites, videos, newspaper and magazine stories, advertorials and advertisements for both franchises and business services. Following Yin (1994), these materials were carefully assessed for bias and used mostly to corroborate and augment evidence from other sources, particularly interviews.

Observation played an important role in the data collection process (Creswell, 1994; Eisenhardt, 1989a; Miles & Huberman, 1984; Patton, 1987; Yin, 1994). Evidence provided by this source is often useful in providing additional information about a case (Yin, 1994). During interviews I followed the advice of Bogdan and Taylor (1975, p. 118-9) who note the use of a tape recorder “does not obviate the need to write down your

impressions and observations after each interview session.... such notes both help you guide future interviews and provide a frame of reference when you later try and interpret your data". In addition to a list of remarks of impressions gained during interviews, observations were also recorded during most contacts with cases. Also, because most interviews (two exceptions) were conducted at the respondent's place of business, I was able to obtain a broader picture of each case. In one company, observing a Franchise Advisory Council meeting broadened my understanding further. In all cases I made sure I recorded observations on the numbers, appearance, and interaction of staff, and, the condition and layout of offices and fittings. Observation notes were added to transcripts (See example in Appendix Four).

The triangulation made possible, by making use of these multiple data collection methods - and multiple sources within each, provided stronger substantiation of constructs and hypotheses, and helped ensure the reliability and validity of findings (Eisenhardt, 1989a; Jick, 1979; Patton, 1987; Yin, 1994).

### **Data Analysis**

Data analysis progressed simultaneously with data collection and management, although the major portion of analysis took place at the end of data collection. Data analysis was guided, in particular, by the works of Eisenhardt (1989a), Miles and Huberman (1984), Huberman and Miles (1994), Stake (1994) and Yin (1981; 1994).

According to Yin (1994), the preferred strategy for analysing the evidence is to follow the theoretical propositions that led to the research. Hence, and guided by Eisenhardt (1989a), I began with a 'within-case' analysis resulting in detailed descriptions for each firm. Cases for each company appear in Chapter 3, Chapter 4 and Chapter 5, and are structured around the research objectives and propositions.

Individual case descriptions were generated from a detailed analysis of interview transcripts and other forms of evidence. I content analysed each interview transcript using a process of sentence-by-sentence pattern coding (Miles & Huberman, 1984; Yin, 1994). Recurrent themes and patterns were noted in the margins of interview transcripts (Miles &

Huberman, 1984; Yin, 1994). All interview transcripts, and other items of evidence, were content analysed countless times during the course of the research. For example, to satisfy the first research objective, I went through each transcript separately, at least twice, searching for data relating to each environmental and task-related factor. This meant each individual transcript was analysed at least 12 times to satisfy that objective alone. Transcripts and other evidence were analysed further to satisfy the second research objective. That was, to identify and describe other factors that influence the choice of franchising forms.

The within-case analysis process was highly iterative. Earlier cases needed to be re-examined for additional factors identified in later cases or during the cross-case analysis. As a consequence, case descriptions were living documents. The descriptions required re-writing as my understanding of each case, and the factors influencing form choice, grew during the investigation (Dey, 1993; Glaser & Strauss, 1967).

Overall, the process of within-case analysis was designed to make me familiar with each case as a stand-alone entity and allow the unique patterns of each case to emerge, before pushing to generalise patterns across cases. Becoming intimate with each case is very important to ensure that the commitment to generalise or create theory does not divert the researcher's attention from features important to understanding the case itself (Stake, 1994). The familiarity also helped accelerate cross-case comparisons (Eisenhardt, 1989a).

Following the within-case analysis, cross-case patterns and themes with regard to each research objective and proposition area were identified (Eisenhardt, 1989a; Yin, 1994). To address whether environmental and task uncertainties influence the choice of franchising forms I ordered the data separately for each factor. I then grouped cases by category of form, namely single-unit franchising, direct multi-unit franchising, and indirect multi-unit franchising. The propositions were tested following the replication logic specified by Yin (1994). This involved two forms of replication: literal replication and theoretical replication (Yin, 1994). Literal replication occurred when two or more cases within a category (such as SportCo and MortCo in single-unit franchising) provided similar results. Theoretical replication occurred when different categories contrasted for predictable reasons (Yin, 1994). Hypotheses were most strongly supported when both theoretical and

literal replication occurred.

Analysing the data in these divergent ways assisted the second objective - that is, to identify what other important factors influence choice of franchising form. According to Eisenhardt (1989a), looking at the data in divergent ways is recommended as a good strategy to counteract the danger of reaching premature and/or false conclusions. I therefore ordered analysed the data in yet further ways. This meant, at some stage or other during the analysis, data were ordered into different arrays by proposition factors and other factors such as, importance of incentives, importance of control, desire for growth, organisation size, access to resources, founder self-image, category of form and specific form. Additional data analysis strategies were also employed. For example, within and across categories of form (e.g., single-unit, direct multi-unit and indirect multi-unit franchising) I listed and analysed similarities and differences, in an attempt to break simplistic frames (Eisenhardt, 1989a) and exhaust explanations from the data. The outcome of the cross-case analysis appears in Chapter 6.

### **Validity and Reliability**

In his book on case study research Yin (1994) specifies four criteria for judging the quality of research designs. These are construct validity, internal validity, external validity and reliability. Satisfying each criterion required specific attention at one or more stages during the research process (i.e., from design to composition).

Two methods suggested by Yin (1994) were employed to improve the construct validity. First, multiple sources of evidence were used to satisfy the information requirements. These included interviews, documents and observations. Second, a chain of evidence was established providing clear links between research questions, data, case reports and conclusions. Construct validity was also addressed earlier in the research process by carefully defining factors in the conceptual model. Eisenhardt (1989a) notes such a priori specification is valuable because it enables more accurate measurement of constructs. This specification then guided the development of the interview schedule, specific interview questions, and probing within interviews.



Internal validity addresses the degree to which the observations and measurements offer a true description of the phenomenon under study (Denzin & Lincoln, 1994). Yin's (1994) analytic strategies of pattern matching and explanation building were both employed during analysis to address this issue. Further, multiple data sources and triangulation were also utilised to enhance the validity of this study. Several and diverse data sources provided examples from different sources. They also sometimes highlighted different perspectives (e.g., franchisor vs. franchisee) that could be specifically addressed and clarified in follow-up interviews and/or phone calls. This resulted in a richer understanding and further enhanced internal validity.

The external validity of this research is addressed by using multiple cases to improve generalisability. The propositions were tested following the replication logic specified by Yin (1994). The method of generalisation using multiple cases is 'analytic generalisation', where previous theory is used as a template with which to compare the empirical results of the case study. Hence, if two or more cases are shown to support the same theory, replication may be claimed (Yin, 1994). The multi-case design here is especially unique in that it allows for two forms of replication: literal replication and theoretical replication (Yin, 1994). Literal replication occurred when two or more cases within primary categories (such as SportCo and MortCo in single-unit franchising) provide similar results. Theoretical replication was enabled with different categories of cases. This replication occurred when contrasting results (in different categories of forms) occurred for predictable reasons (Yin, 1994). Consequently, through involving heterogeneous forms, the research design broadened the applicability of findings.

Finally, providing enough information so that another investigator researching the same case could reach the same conclusions satisfies reliability issues. Detail in the conceptual framework and research design helped to address these issues.

### **Limitations**

The results of the study need to be put into the context of its limitations. First, this study is primarily retrospective, relying on some informants to recall events and circumstances more than 15 years previously. This was not viewed as a major limitation, however, because deciding to franchise a business can be regarded as a memorable event, and only

two of the informants were required to think back this far. In addition, utilising multiple informants and data sources meant evidence could be corroborated.

Second, it is possible some informants might have substituted idiosyncratic decision-making with clear-headed reasoning shaped from experience. I was confident, however, given the candour of most informants regarding past mistakes, that this was limited. Furthermore, entering the field with a broad understanding of the issues (Yin, 1994) meant I was alert to any inconsistencies and unlikely stories. The potential for negative impact from this area was also limited by employing multiple data sources.

A third, but unavoidable limitation in this research was the use of a single investigator. Eisenhardt (1989a) suggests that multiple investigators can improve both the creative potential and confidence in findings, with case study research. This limitation was addressed through regular meetings with my supervisory panel and colleagues to discuss findings and ideas.

A fourth limitation pertains to the generalisability of results. The applicability of my findings to outside contexts is potentially limited by the focus on domestic operations of New Zealand-founded franchise systems. With a population of less than four million, the market for goods and services in New Zealand is small relative to others economies such as, the United States, United Kingdom, Canada and Australia. This size means chains operating an identical concept would have the potential for fewer units in this economy compared to other larger economies. Given that demand size had an important influence on franchising choices in this study, this potentially limits the generalisability of my findings to economies of a similar size.

## CHAPTER 3

### CASE DESCRIPTIONS: SINGLE-UNIT FRANCHISING

#### Introduction

This chapter, Chapter 4 and Chapter 5 present the case descriptions of seven companies representing the three primary categories of franchising forms, namely single-unit franchising, direct multi-unit franchising and indirect multi-unit franchising (see Table 3). The presentation of case descriptions is ordered by organisational form. This chapter discusses cases representing single-unit franchising (MortCo and SportCo). The next chapter presents companies adopting direct-multi-unit franchising (VideoCo and RealCo). Chapter 5 examines indirect multi-unit franchising (SnackCo, ServCo and FastCo).

**Table 3**  
**Company Descriptions**

Franchising Category	Companies	Chapter
Single-unit franchising	MortCo SportCo	Chapter 3
Direct multi-unit franchising	VideoCo RealCo	Chapter 4
Indirect multi-unit franchising	SnackCo ServCo FastCo	Chapter 5

The cases are descriptions and follow format consisting of four primary sections: Background, Development, The Environment and a Summary. The Background section provides a brief business description and explains the franchising form. The Development section details company and franchise development. In addition, it identifies and explains

important factors contributing to form choice. The Environment section presents and explores factors representing environmental uncertainties. This also includes my analysis of task uncertainties. Each case description concludes with a summary of the factors influencing franchising form choice.

## **MORTCO**

### **Background**

MortCo is a mortgage broking business that provides prospective and existing property owners (clients) with free assistance and advice on obtaining property finance. Founded in 1991, MortCo comprises a network of 27 mortgage consultants (or brokers) located throughout New Zealand. These consultants match client requirements with the optimal lending product selected from more than 10 different financial institutions. The institutions reward MortCo with a commission, in proportion to loan size, for successful loan applications.

The mortgage consulting process typically occurs as follows. Clients are drawn to MortCo consultants from two primary sources: 1) company advertising or 2) real estate agent referrals. Consultants interview clients to establish a clear understanding of their circumstances and requirements. The objective is to collect sufficient (and accurate) information (e.g., on income, deposit size, type of deposit, mortgage size, risk aversion, credit rating etc.) from clients to advise on the most suitable lending product. After some analysis, often in a second meeting, the consultant presents the client with a list of relevant lending options. At this point the consultant explains the relative merits of each lending option to the client. With the client's agreement on a particular option, a loan application is then prepared and submitted to a financial institution. Successful loan applicants are offered mortgage protection insurance by the consultant.

MortCo's organisational form is organised as a single-unit franchising form, where MortCo consultants are predominantly owner-operating franchisees. Only one mortgage consultant can operate per franchise agreement which means franchise holders cannot hire additional consultants. However, to maximise productivity, they are encouraged to employ personal assistants.

The franchisor charges an initial fee to become a franchisee. Once established, consultants pay a percentage of commissions to the franchisor as a royalty payment. Franchisees are also obliged to contribute a percentage of commissions to separate individual and joint

advertising funds. Franchisees are not awarded an exclusive territory, but one of a limited number of licenses to operate within a larger area. For example, in the metropolitan area of Christchurch, New Zealand, MortCo has a limit of twelve licenses (six of these twelve licenses were awarded at the time of this investigation).

Based in Christchurch, the MortCo franchisor recruits, trains, socialises and supports franchisees. The franchisor also provides overarching management for the entire system. This includes activities such as organising and controlling the range of institutions and lending options represented, new product/service developments, organising advertising, arranging annual conferences, regular regional consultant meetings and franchise advisory council sessions. Franchise brokers, who are employed to attract and recommend prospective franchisees to the franchisor, assist the franchise recruitment process in Wellington and Auckland.

MortCo had two minor exceptions to the single-unit form. In the first, a company purchased a franchise and hired an employ to provide mortgage services. In the second, MortCo has allowed a husband and wife partnership to simultaneously operate under one franchise agreement. Both exceptions occurred in geographically dispersed where there was little potential for additional MortCo growth.

## **Development**

MortCo pioneered independent mortgage consulting services in New Zealand. The founder recognised an opportunity for the service following personal experiences obtaining property finance. Prior to the establishment of MortCo, property investors approached lending institutions directly.

The founder began operating with a personal assistant in 1991. Demand grew rapidly and consultants were hired to develop the business. By the end of 1997 MortCo comprised 30 employee mortgage consultants who were located throughout New Zealand. In 1998, the founder and key executives decided to franchise operations, and convert existing consultants to franchisees. All consultants were offered franchises at a substantially discounted price. Not all embraced the new opportunity, however. Some left to start a

competing operation while others took positions in that operation or other competing businesses. Those that remained appreciated the profile and good name of MortCo in the market place. They also believed MortCo's service was superior to competitors. Following the departure of some employee-consultants, a number of new franchisees were recruited. By mid-1999, MortCo comprised 27 franchisee mortgage consultants.

### *Franchise Imperatives*

The development of organisational form at MortCo was influenced greatly by two factors. The first factor involved a desire to improve consultant motivation. The founder and key executives felt increased motivation would improve consultant productivity, commitment and loyalty. The second factor was a desire to maintain adequate power and control over consultants.

Prior to franchising, the founder changed the structure of consultant remuneration to improve productivity. The founder observed that consultants relied too heavily on sales derived from generic company advertising, arguing they needed to network and build referral relationships more aggressively. Initial consultants were paid a retainer and earned commissions based on successful loan applications. The retainer was later removed so consultants derived remuneration solely from commissions. Removing the retainer and increasing consultant commission was designed to provide consultants with additional motivation. Productivity did improve with each amendment; however, the founder felt most consultants continued to perform below their ability. Furthermore, problems, such as consultants bad-mouthing MortCo and/or defecting to competing operations, existed indicative of a lack of consultant commitment and loyalty to the MortCo brand.

The decision to franchise operations was also motivated by the desire to improve consultant performance and loyalty to MortCo. The founder and key executives believed that franchising would lead to greater motivation and commitment to the overall organisation. After paying the franchisor the initial fee consultants, as franchisees, earn a greater proportion of total commissions. At the same time, they also became responsible for operating expenses previously covered by MortCo, such as office rental, phone rental, stationery, secretarial staff etc. Importantly, both franchisees interviewed said that their focus and productivity improved dramatically with the conversion from employees to

franchisees. That corresponded with the marketing manager's observation that consultant productivity had doubled in Christchurch since franchising.

The Marketing Manager also indicated that the reduction of parent company risk was an additional benefit of franchising:

*One of the crucial problems that we were facing (prior to franchising) was the only people that were guaranteed income were the consultants. In other words, they were absolutely guaranteed their margin and their overheads were covered by the company... The objective of franchising is we pass on all the costs. In other words, the only person which is guaranteed their section of the income is us... The bulk of the risk is now with the franchisees, as in, if they don't get up in the morning then they don't generate income, but their costs of operating the business are still incurred.*

Franchising was also hoped to improve consultant commitment and loyalty to the MortCo brand. As employees, consultants demonstrated a general lack of commitment and loyalty to MortCo. They operated in a market where job mobility was high. The founder felt that investment in a franchise might help secure more long-term commitment to MortCo and help deter consultants from defecting to competing organisations:

*I guess more than ever I have started to realise that commitment is one of the biggest things - commitment and long-term loyalty. It just pees me off when I have to lose people... I mean no one has left under the franchise system. There is no reason why someone would walk away from their \$60,000 commitment.*

The motivational imperative also influenced MortCo's analysis of alternative franchising forms. Franchising forms that involved owner-operating consultants, such as single-unit franchising, area representation and subfranchising were clearly favoured over those involving employee-consultants, including sequential franchising and area development. This preference is reflected clearly in the following quotations:



*This one [area development] would never work in our operation because the focus of what we require is that owner-operator - right. So in other words, this one has been taken completely out of the operation... This one [sequential franchising] is a possibility from how much control we want but we always look at this position as being reasonably redundant because it must be more of a hands-on role (Marketing Manager).*

*I would have to give it thought and everyone would be judged on its merits but I don't think you would get the same commitment [with sequential franchising]... Because you have then employed somebody and you have gone the full circle and you have got employees and if it works the type of person you need has got to be intelligent enough to be able to run his own business. So effectively you have employed him to run your business. It doesn't take them long before they think 'oh yeah, I'd rather do this for myself.' So my view is that you wouldn't get the same level of commitment (Founder).*

The franchisor's need for control also influenced choice of franchising type, both in terms of the initial decision to franchise, and the analysis of alternative franchising arrangements thereafter. Control was desired to enforce operating standards and ensure the smooth implementation of important adaptations. Franchising provided an advantage in that the franchise agreement imposed more rigorous standards on operations. For example, the Marketing Manager noted:

*This is where the control side of it comes in. That is why the structure is set up the way it is because we need to maintain absolute control. In other words, if we just gave the franchisee the rights to 'well here's the rights to a brand name go and use it,' then we could very quickly lose control. And again, why we haven't franchised general areas to operators is because then we are reliant on those operators without being able to control what they do. So that is why we put in a franchise where we are more heavily involved in the control side of operating the business.*

The franchisor also strongly desired power and control in order to effectively implement new initiatives. Franchisor executives noted the frequent need for adaptation. They said

that, because they are often first-movers, power over consultants is required because new initiatives may, in turn, require adaptations. That need for power and control highlighted MortCo's preference for a direct relationship with franchisees. Single-unit franchising was clearly favoured over indirect forms, area representation and subfranchising, because it provided a direct contractual and operational relationship with each and every consultant. The Marketing Manager confirmed the importance of a direct relationship in facilitating adaptation:

*We have to keep the direct control as we develop any new markets or opportunities so we need direct control on how that is done. When we introduce something new it is all new because it hasn't been done before. So like anything else, you can't just be absolutely concrete and say well 'that is going to be the way that it is done come hell or high water' [or] it is going to fail. You have got to evolve.*

Franchise executives also considered single-unit franchising as an introductory or base franchising form that provided them with the power and flexibility to adapt form in the future. Exemplifying this view, the Marketing Manager stated:

*Basically our current structure is this [single-unit franchising] with the facility to either operate something like this [area representation] or, either of these others [area representation or subfranchising]. I mean we have factored in future growth right, that is about the franchisees contracting to MortCo and MortCo can subcontract. The franchisees have absolutely zero rights over how the franchisor is structured.*

## **The Environment**

### ***Market Size***

While MortCo's demand was growing rapidly, the potential for increases in size was ultimately limited. The franchisor executives felt that few additional consultants would be required because demand size in New Zealand is limited. The executives accepted that administrative duties would increase with size, but noted that they were unlikely to become problematic. Tasks of recruitment, training and ongoing management therefore

were, and would continue to be, adequately catered for within the existing structure. Consequently, single-unit franchising was considered the optimal franchising arrangement. Demand was considered too small for area representation and subfranchising to be viable. Furthermore, as the Marketing Manager illustrated, these indirect multi-unit franchising forms offered few administrative advantages given their market size:

*At this stage there is not enough in mortgage broking; it is a limited market, it is a readable market, so even if we maxed it out our requirement would never be any different...[Further] for our current sizing we are still able to concentrate on each market individually, we still have the resources in our organisation to do that.*

Larger demand size would increase the utility associated with indirect multi-unit forms, area representation and subfranchising, as more consultants would put pressure on the current structure to the extent changes in form could be necessary. For example, the Marketing Manager and founder stated:

*If it had the potential of 1000s of people working for us in Auckland, then we wouldn't come up with the structure that we have got. I think the structure has built around the criteria. It is like anything else, if you alter one part...if you tweak the motor the gearbox starts to whine.*

Both the founder and Marketing Manager agreed that the burden of managing many more franchisees would lead them to consider area representation and subfranchising more favourably. The founder stated:

*I am happy with the structure that we have got at the moment with the size we have got but if we had twice as many in Auckland, either I'd have to shift to Auckland, which is probably not likely, or we'd give more serious thought to one or two of the other options [area representation and subfranchising] we had discussed.*

### ***Market Growth***

Since pioneering the industry in New Zealand, MortCo had witnessed rapid demand growth. Ten years ago there were a similar numbers of houses for sale but investors approached lending institutions directly. As the awareness for mortgage broking services has increased, so too had demand. The Marketing Manager estimated total market demand growth to be around 20 percent per annum. At the same time, however, competitors emerged rapidly.

Rapid demand growth highlighted a need for more consultants. However, while this need was part of MortCo's analysis, it did not influence actual form choice. In their analysis the MortCo founder and executives felt frustrated with the pace of growth achieved with single-unit franchising. Despite the advantages associated with indirect forms, area representation and subfranchising, MortCo ultimately preferred single-unit franchising.

The franchisor's desire to increase loan applications per-consultant in the context of a rapidly growing market did, however, influence form choice, by highlighting the importance of providing consultants with adequate motivational incentives. As previously identified, the desire to improve consultant performance was evidenced first, by the evolution of consultant remuneration prior to franchising, and second, by the decision to convert consultants to franchisees. Further, within franchising, MortCo selected single-unit franchising because it provided consultants with unrivalled incentives to work productively. Other franchising forms, including sequential franchising and area development, were rejected because, by involving employees, they failed to provide consultants with adequate motivation.

### ***Customer Dispersion***

Demand for mortgage broking was quite dispersed and, reflecting that situation, MortCo had consultants located in many regions throughout New Zealand. This dispersion provided MortCo with unique problems and challenges that prompted franchisor executives to consider the merits associated with alternative franchising forms. Difficulties associated with dispersion involved two areas of operations. These included recruiting more consultants and increasing consultant productivity. Franchisor respondents identified

that increased local support would assist both areas. Nowhere were frustrations more apparent than the founder's evaluation of Auckland. MortCo was comparatively under-represented (in relation to competitors) in Auckland, New Zealand's largest city and region. That under-representation led both franchisor informants to consider the following three structural and franchising alternatives. First, the founder contemplated relocating himself to Auckland. While relocating was later discounted for personal reasons, he stated:

*I mean if I was up there putting the same amount of energy into Auckland - you know it is costing me a lot by living in Christchurch.*

Second, informants considered employing a regional manager to support MortCo growth and consolidation in Auckland. This alternative, however, was also disregarded. Informants felt an employee would have inadequate incentives to meet the franchisor's high expectations for the role. For example, the founder noted:

*I certainly think that you know if it can't be me then it should be someone as motivated as me that had owned the contract for the area.*

Third, and finally, area representation and subfranchising were considered. These forms were favoured over a hired regional manager because, by involving ownership, they were more likely to provide regional managers who were motivated to work productively. The founder stated:

*So if they build the Auckland volume up it is a credit to them. So if they double the size, I'd envisage collectively off the group of guys that would provide X amount of income but that they could add on so many more [consultants] and their income would go three-fold. So it encourages them to build and recruit, to improve productivity in all areas, efficiencies and increase and maintain morale.*

Despite the advantages identified with indirect multi-unit franchising forms, franchisor executives ultimately felt that the level of dispersion did not justify discarding their current form. They still considered single-unit franchising to be the most appropriate type of franchising to use in this context. However, while single-unit franchising was embraced generally, demand dispersion did influence form choice in two small, isolated locations.

This was evident in two minor exceptions to the pure single-unit form. Two franchise arrangements provided their franchise holders with additional rights and responsibilities. The first involved a company hiring an employee as a mortgage consultant. The second involved two individuals consulting under one franchise agreement. Both occurred in small, isolated markets with little prospect for further expansion. The size and isolation of those markets have influenced the decision to allow these exceptions. Because of their isolation they are expensive for the franchisor to support and visit. Furthermore, the small size and low potential for future growth increased this cost relative to similarly isolated, but larger markets. Consequently, as stated by the founder, they received less support than those consultants located in larger areas:

*Because of geographical location I don't visit Nelson or Tauranga - like Whangarei, I have done initial things, but I haven't spent a lot of time there. I tend to go (fly) Christchurch-Auckland or Christchurch-Wellington-Auckland. The downside for them is maybe because Nelson's to be blunt is not firing I can't afford to. Arguably you say I should be spending time there but I am trying to focus. Most of our income potential is out of Auckland so I tend to spend a lot of time up there.*

The additional benefits afforded to the two exceptions were designed to offset disadvantages associated with receiving less direct support. As the Marketing Manager stated, this solution might also be used in similar, future situations:

*We are taking this on a developmental basis. In other words, how we physically structure any future arrangement is yet to be determined on the basis of what we will require. But the objective at this stage is that hey, that is an area we don't want to have too hands-on a role in that area so they have, you know, taken Tauranga with extra rights, I suppose, or extra possibilities, of having more of an area development [agreement]. Because [if] you take the franchisors income from an area like Tauranga and then the costs of servicing that as a franchisor - we are better off to pass on the management of that to the operator in the area.*

## **Competition**

Competition had a more major influence on form choice. Competition in the mortgage broking sector has grown at a meteoric rate to the extent that literally hundreds of different competing operations now exist. While demand had also grown rapidly, informants said that growth in competition was more marked. Characteristic of competitive pressures, defending market share became more difficult, despite a large advertising expenditure. Further, profit margins were diminishing. The founder stated:

*Suddenly the margins come down and we are now at the margin - before I worked on a 30-40% - I ran my company on the philosophy of a third wages and salaries, a third overheads, and a third profit, and I assure you that our profit margin is nowhere near that now. Even if it was half that I would be thrilled. It has been brought into line, basically because people say 'you can't have that sort of profit because we want a slice of the action.' So it has got tough, it has certainly got more competitive, and when I think of the energy and effort and the momentum that we have got, we should be streets ahead. But it is just that basically we are dragging all the other mortgage brokers along; they are all eating in our pie.*

Two key challenges were identified in response to this situation. These included maintaining both unit-level (consultant) and system-wide efficiencies. For example, the founder noted:

*I have just got to mind my own business, look after our efficiencies and our income and all the factors within our company and just aim it at that - I just know that everyday there is someone else out there and it is like that. You have got to go and fight wars every day.*

These challenges highlighted the advantages of single-unit franchising relative to other forms. Concerns for unit-level productivity highlight advantages associated with owner-involvement. In comparison, direct multi-unit forms involve employees as consultants. Considerations for system-wide efficiencies highlighted advantages associated with centralising franchise management activities (such as, recruitment and ongoing-support). In contrast, indirect multi-unit forms involve the duplication of these franchisor activities.

Importantly, while informants recognised the potential advantages of indirect multi-unit forms for improving unit-growth and productivity, they were concerned that the added costs of master franchisees could threaten MortCo's viability.

### *Demand Heterogeneity and Task Complexity*

Demand for mortgage broking services was quite heterogeneous. Clients have widely varying circumstances and preferences, across a range of factors, which combine to influence the suitability of different loan options. For example, client circumstances comprise a wide range of variables that included the size and term of loan required, size and type of deposit (gifted or not), and level of income. Clients may also have assets, outstanding liabilities and future plans and investment needs that are important to the loan application, as well as different preferences regarding alternative methods of repayment. It was clearly evident from the interviews that while clients shared the same general requirement of needing finance, their circumstances varied widely. For example, the informants stated:

*There is quite a range. I mean the people we deal with vary in very varying degrees (Franchisee)*

*Their only common thread is that they need finance. Other than that, every case is different (Marketing Manager)*

*100% of them want a home loan or home finance but obviously everyone is going to have different circumstances (Founder)*

This heterogeneity added to the complexity of consultant tasks. Accurately establishing client circumstances is challenging, and central to a consultant's ability to recommend the optimal mortgage option. Consultants must be skilled interviewers. Critical analytical skills are also important as clients commonly withhold important information (e.g., hire purchase payments) and overstate their income. Thus, as one franchisee noted, the client interview can involve concentrating on and analysing much more than what is said:



*People don't want to tell you things ... If you ask about hire purchase or credit cards or whatever and they think because there are only three or four payments to go that you don't need to know... Some banks will say if you haven't disclosed that hire purchase on your application non-disclosure is reason to terminate the application... Therefore the bank no longer trusts that client. Then they will over-emphasise their income: 'You know, I'm on 35 grand a year it is not a problem.' You get something through from their employer and nut out the figures and they are stretching to get to 32... So long as you can extract those subtle bits of information, but you have got to listen to absolutely everything they say. They might give out a little clue.*

The range of lending products and options added to the complexity. Consultants must have an intimate knowledge of the wide range of lending products that they represent. One MortCo franchisee/consultant put this in perspective by contrasting his experience as a lending manager at one well-known bank:

*When I was at Trustbank I just knew one lending product... with this I have to know 10 different lending products, and be able to match the clients requirements as best we can around where they are at to the best deal.*

The lending criteria and policies of banks are subject to regular changes, adding an additional source of complexity. Further, obtaining the best deal sometimes requires challenging a bank to customise a package to suit an individual's requirements. Consequently, MortCo consultants must have an intimate knowledge of lending criteria and policies of a wide range of lending institutions and keep up to date on any changes to criteria or new lenders represented.

The process of identifying the optimal lending option is difficult and complex. Many different individual circumstances mean that clients may not be eligible for all loan options. The different loan options investors might be eligible for provides them with choice, within which the consultant can advise and/or the client can exercise personal preference. The following extended quote made by the Marketing Manager outlines a common scenario that illustrates the complexity:

*Given your situation how do you want to structure your loan? For most people they think 'mortgage' and it is going to be x amount per month and we pay till doomsday. But it is well past [that]. In other words, you can change the amount you pay, you can go interest only for a period of time, you can do this, you can do that, you can structure anything. So like, do you want to pay this off quickly? What other things do you want in your life? So how you structure that is quite important as to which institution we put you [to]...[and then] what sort of things do you want? Do you want to go and lend more money in the future for other things - like investment properties - and do you want to keep it pushed out on the maximum so you can get the old car and the you know? How are you going to structure your finance, because you can do that through your mortgage, and if you are going to do that through your mortgage then this is the one for you, and actually it is going to cost you slightly more but in the long term you are going to save this and this you know - and then, if you do need \$20,000 dollars more to go and buy a car on today's rates, you'll be paying 10 percent above that. But you can do it with this and that is when it gets really technical to come up with what is the end result.*

In summary, the consultant's role is complex. New consultants can expect to operate for a year before feeling confident. Difficult scenarios continue to arise, however, even for the most competent.

Two key franchisor functions were identified as essential in order to successfully manage this heterogeneity and task complexity. These were franchise recruitment and training. Franchisor executives regarded the quality of both as essential, and this influenced form choice. Such was the importance of these functions that the franchisor resolved to perform them in-house. Further, with regard to recruitment, the founder personally controlled all selection decisions. MortCo also ascribed similar levels of importance to training. Regardless of background, all new recruits underwent a two-week class-based training course provided by the franchisor. The training programme was intensive and difficult. A wide range of material needed covering due to the complexity of operating. As the founder stated, all recruits, who included professionals, such as ex-bank lending managers, and even accountants, found the training challenging:

*Most people, the accountants, for example, that have done our course still find it a lot to take in. It is a pressure course over two weeks. No one has actually flown through as a breeze, they have actually found it 'shit there is a lot to learn.'*

The importance ascribed to recruitment and training quality influenced choice of franchising form. Single-unit franchising was explicitly preferred over area representation and subfranchising because it enabled the franchisor to control the quality of recruitment and training. Centralising rather than delegating one or both activities achieved this. Interestingly, one indirect form was preferred over another on this basis. Area representation was regarded more favourably than subfranchising, because it involves only the delegation of training.

### **Summary**

Founded in 1991, MortCo now has a network of 27 mortgage consultants located throughout New Zealand. With two minor exceptions MortCo's form is characteristic of single-unit franchising. MortCo began franchising in 1998 after eight years of company expansion. During this period the structure of consultant remuneration evolved from a high retainer/low commission-based mix to 100-percent commission. Now, as franchisees, consultants are residual claimants. They pay an initial franchise fee and a regular royalty payment, and assume many of the operating costs previously covered by their employer. In return, consultants now earn a greater share of commissions.

The adoption of single-unit franchising, and the development of form that preceded this, was influenced markedly by two factors: incentives and control. Both factors reflected the personal beliefs and choice of key decision-makers. The first factor, a desire to improve consultant incentives, influenced choice by highlighting the relative disadvantages associated with alternative organisational arrangements and franchising forms. Key decision-makers believed residual claims, through ownership, provide consultants with better incentives than other options. Alternative arrangements to this single-unit franchising form, such as employee-based compensation schemes, sequential franchising and area development, were all rejected on the basis they either reduce or remove owner-

involvement at the consultant level.

The second factor, a desire for control, influenced form choice differently. Franchisor informants desired control over consultants to ensure the quality of franchisor related activities (e.g., recruitment, training and monitoring), enforce operating standards and ensure the smooth implementation of much needed adaptations. Single-unit franchising was advantageous compared to company-owned operations because the franchise agreement imposed more rigorous standards and penalties for non-compliance. Single-unit franchising was preferred over alternative franchising forms, such as area representation and subfranchising, because it involved maintaining a direct relationship with consultants. By contrast, the founder and key executives felt area representation and subfranchising reduced franchisor control to an unacceptable level.

Franchising form choice was also influenced by factors representing environmental and task uncertainties, namely demand size, growth, dispersion and heterogeneity, intensity of rivalry and task complexity. Demand size, in particular, influenced form choice strongly. Limited demand size highlighted advantages associated with single-unit franchising, through maintaining direct control and high levels of owner-involvement. Other forms threatened advantages associated with these characteristics, while offering few benefits in return. Further, franchisor executives considered the potential scale of operations would be insufficient for two alternatives to be viable, namely area representation and subfranchising.

Despite strong increases, the level of demand growth had only a minor impact on form choice. High demand growth highlighted the importance of increasing consultant numbers and sales per consultant. Despite a strong desire to build consultant numbers, however, single-unit franchising was selected over alternative forms (i.e., all multi-unit franchising forms) that facilitate more rapid unit-growth. By contrast, the concern for consultant productivity did influence form. Franchisor executives preferred forms, such as single-unit franchising, that maximised owner-involvement at the consultant level.

Demand dispersion also had only a minor influence on form choice. The level of dispersion highlighted advantages associated with alternative forms, such as area

representation and subfranchising. However, these advantages were insufficient to warrant the replacement of single-unit franchising. Single-unit franchising was considered most appropriate in this context. Dispersion influenced form most in two small, isolated locations. Unable to provide comparable support to these locations, franchisees were granted greater latitude in their franchise agreements.

Competition had a more major influence on form choice. Intense rivalry highlighted the importance of preserving and maintaining unit-level and system-wide efficiencies. Franchisor executives preferred single-unit franchising in this context because it offered advantages over both direct and indirect multi-unit forms. Comparatively, direct multi-unit forms reduced unit-level efficiencies (i.e., consultant productivity) by lowering the level of owner-involvement. Compared to single-unit franchising, indirect multi-unit forms add system-wide costs by duplicating franchisor-related activities. Consequently, single-unit franchising was, in part, selected because it preserved unit-level and system-wide efficiencies.

Finally, demand heterogeneity and task complexity combined to strongly influence form choice. The high complexity of unit operations increased the importance of ensuring the quality provision of two key franchisor management activities: recruitment and training. Single-unit franchising was preferred in this context because it involved the franchisor directly undertaking both activities for all consultants.

## **SPORTCO**

### **Background**

Founded in 1964, SportCo retails general sporting equipment from 50 stores. The stores are located throughout New Zealand's large and small cities, and rural townships, and trade from a diverse range of situations, including main streets, side streets, strip shopping centres and malls. Stores stock between 2000 and 7000 different items and employ up to eight-full time and ten part-time staff.

All 50 SportCo stores are franchised and single-unit franchising is the dominant form. 43 of 50 stores are owned and managed by single-unit franchisees. Exceptions include two separate franchisees that operate two stores. The exceptions were characteristic of sequential franchising. The remaining three stores are organised differently. One franchisee owned one store outright and shares ownership in two further stores, with a separate partner in each. This form is termed the Franchise Partnership Structure (FPS). Operating this form, each partner manages his or her respective store.

The SportCo franchisor charges an initial fee and regular royalty payments, based on a percentage of sales, for rights to operate a franchise in an exclusive territory. In return, the franchisor provides overarching chain management, including support and services for franchisees. Franchisor support includes some centralised purchasing.

The franchisor comprises more than 10 support staff, including a managing director (not the founder), and four functional managers (marketing, purchasing, accounting and business development). Three have assistants. Additionally, the franchisor comprises secretarial staff, and the principal founder (there were two), who continues to play an active role in the business.

### **Development**

Founded by two friends, the first SportCo store opened for business in Auckland in 1964. Sales and financial resources grew steadily and a second store was soon established in

partnership with two former employees. This performed poorly, however, and SportCo's founders purchased their partner's share in the store. After improving this store's performance, additional expansion was sought. The founders realised the potential for economies of scale:

*We got to have two stores and thought we needed three. So at that stage we started to formulate plans as needing four then five, and then you started to see the benefits of growing and size (Existing founder).*

Two additional Auckland stores and four more in Wellington grew SportCo's retail network to eight company-owned stores by 1982. Content with their achievements, the co-founder suggested both founders consider retirement. Not sharing the sentiment of his co-founder, the existing founder (referred to herein as 'founder') purchased his share in the business, and set about expanding the network further. Later that year, he decided to start franchising to achieve additional growth. This followed an approach from a consultant interested in facilitating the process.

### ***Franchise Imperatives***

The initial decision to franchise was motivated by two central concerns. The first pertained to access to capital. Their financial resources did not match SportCo's ambitions for growth. As the founder stated, franchising was advantageous compared to company-owned expansion because it introduced external financial resources:

*To open another [company-owned] store was going to cost \$100,000 to buy the site [and] to buy the fixtures and fittings and stock, and it had to be tax paid money. At one stage I was paying 66 cents in the dollar tax, so if they are going to take two thirds of your money you haven't got much left. So the opportunities available never matched the money available... the reason to franchise was that I bought someone's new money in. It was money in, not out.*

The second concern pertained to improving the incentives for store managers. Prior to franchising, SportCo was plagued with store theft, high levels of absenteeism, and low productivity. Making managers owners of stores, as franchisees, was seen as a solution to

these problems. As the following quotations illustrate, perception became reality. Concerns of staff dishonesty dissolved and productivity improved:

*You don't have to worry about theft because the owner is there on the job in the store. One year we lost \$13,000 from the backroom at Christmas in Henderson. A manager in-store has to be honest and if he is going to be dishonest he can rip you off in big chunks. So the loss is [now] theirs (a franchisees) it is not ours – so we have noticed a huge change (Founder).*

*Anything up to a 50% increase in sales in a franchised store as opposed to company owned stores (Founder).*

Five franchises were established within two years, bringing the total number of SportCo stores to 13. The founder's confidence in franchising increased with experience to the extent that he embarked on converting all company-owned stores to franchises. New franchise expansion continued alongside the conversion process, and SportCo's retail network grew to its current size of 50 stores.

Single-unit franchising dominated SportCo's franchise development. However, while owner-operators control 43 of 50 stores, there were exceptions. Four stores were controlled by two franchisees (who have two stores), and three were organised in a Franchise Partnership Structure (FPS).

The founders desire to provide store manager with adequate incentives strongly influenced the initial decision to franchise and the choice of franchising form. Franchising, as stated earlier, was initially selected in preference to company-ownership, in part, because it provided store managers, as franchisees, with better incentives than employee-based store managers. Franchisor executives also evaluated alternative franchising forms on the basis of incentives. The executives preferred single-unit franchising because it maximised owner-involvement in individual stores. Franchisor executives rejected alternative forms, such as sequential franchising and area development primarily because they reduced the level of owner-involvement in store management. Incentives were also important in franchisor comparisons of the FPS and sequential franchising. As the Managing Director



stated, the FPS was preferred to sequential franchising because it involved higher levels of owner-involvement in individual stores:

*I mean because the whole thing about franchising being successful is the franchisee owner-operator on the shop floor driving the business, and if they own two stores then, in effect, they remove themselves to a degree from that... Instead of the franchisee couple focused on one store they are focused on two stores (with sequential franchising) and OK while there are some economies of scale, they are splitting their energy and start losing the franchisee involvement in the business. In comparison, with the franchisee partnership (FPS), you are actually leveraging more franchisee resources, because you have got one franchisee partner one hundred percent working in the business plus another adding 10, 15 or 30 percent input into the business. So you are actually, as I say with the wisdom of hindsight, it makes perfect sense, because with the partner structure (FPS) you put in more franchisee resources, but with the multiple-store owner you actually take franchisee resources away.*

The franchisor informants said that, while single-unit franchising will continue as the dominant form, the FPS would be preferred over sequential franchising for any future franchisee expansion that might be permitted.

Franchisee ambition, the second factor, influenced the utilisation of the FPS and sequential franchising. As the Managing Director noted, this involved some successful franchisees applying for, and being granted with, additional stores:

*Some of our successful franchisees had a desire to do more than one shop, basically. I mean that is essentially where it has gone. And sort of over a period we have had, and still do have now, individual franchisees or franchisee couples who own more than the one store.*

Multi-unit ownership is not encouraged at SportCo. With great importance ascribed to owner-involvement in store management, and a willing supply of new franchisees, SportCo preferred the single-unit form.

## **The Environment**

### ***Market Size***

Franchisor executives considered the size of market demand for their services and concluded that, based on the current store format, full market penetration would be achieved with approximately 10 more stores (i.e., 60 SportCo stores). On this basis, single-unit franchising was considered most appropriate. Franchisor executives rejected area representation and subfranchising because they felt their network was insufficient in size for these forms to be viable. Interestingly, even if size was doubled, franchisor executives continued to doubt the viability of area representation and subfranchising. Consequently, as stated by the Managing Director, while franchisor executives acknowledged the burden of franchisor management would increase with twice as many stores, single-unit franchising would continue to be preferred:

*I don't think it would change our structure, but it just would change the tasks and things that we did, and we would not necessarily allocate it out.*

### ***Market Growth***

Demand growth had some influence on form choice. SportCo experienced two different contexts pertaining to demand growth. The first context related to a major portion of SportCo's development. Until recently, SportCo experienced a long and sustained period of demand growth. The second context related to SportCo's current predicament that was characterised by a plateau in demand growth. Explaining this variation in demand, informants cited lifestyle changes and a shift from sports-related to alternative activities, such as visiting cafés and playing computer games. The two contexts influenced form differently. SportCo concentrated somewhat more on growth in store numbers during earlier, more rapid demand growth. Franchisor executives preferred franchising to company-owned expansion because it overcame growth impediments associated with limited financial resources. Furthermore, while single-unit franchising dominated form, a small number of existing franchisees were also permitted to establish additional outlets. More recently, however, the decline in growth has shifted the franchisors' emphasis toward improving and maintaining existing store performance. Slowing growth has

highlighted the importance of maintaining SportCo's current position in what are more difficult trading conditions. In this context, providing store managers with adequate incentives is crucial for maximising unit-sales growth and profitability. Informants clearly preferred forms that maximise owner-involvement in individual stores. Consequently, single-unit franchising is preferred, and within alternative forms, the FPS was preferred to sequential franchising.

### *Customer Dispersion*

The dispersion of demand influenced form choice. SportCo has located stores throughout both the North and South Island of New Zealand to reflect the dispersed nature of demand for sporting goods. Effects of this dispersion highlight the importance of incentives. For franchisor executives, the effects of dispersion include difficulties involved in observing and controlling dispersed store activities. Dispersed stores are also expensive to visit. The difficulties and the expense associated with dispersed stores highlighted the importance of providing individual store managers with good incentives. All informants (including the franchisee interviewed) said that store managers perform best, and therefore require less monitoring and support, if they are owners or part owners of the stores they manage. This recognition contributed to form analysis and choice. The original initial foray into franchising had highlighted the merits of making store managers owners. This then influenced future decisions. Franchisor executives preferred single-unit franchising because it maximised owner-involvement in individual stores. But also, where franchisees were permitted to expand, the FPS was preferred to sequential franchising because it maintains owner-involvement in all stores. The franchisee concurred with this view by recounting his own experiences managing dispersed stores. He shares ownership in stores more than four hours drive from his own. He said that having a partner that shares ownership (as opposed to hiring an employee) to manage an isolated store reduces both his concerns and the number of times he needed to visit.

### *Competition*

Historically, competition in the sporting goods sector has been strong, yet it has intensified of late. Two years ago a large Australian chain entered New Zealand and established seven mega-stores offering goods at very competitive prices. This had an immediate and marked impact on the sector; one 32 store chain failed, as did another operation with 50 years

trading history. Others have retrenched, some by more than 50 percent. The impact on SportCo was less severe. Informants attribute this to purchasing power due to size, unique locations and dedicated store owner-managers. Yet, while SportCo has maintained size, sales have been affected and price competition is more widespread. These effects, in turn, contributed to an increased focus on two management challenges, namely improving and maintaining store-level performance and system-wide efficiencies.

All informants (including the franchisee) acknowledged the need for diligent store managers for improving and maintaining store-level performance. They felt that store managers must [at least] operate efficiently, be responsive to both customers and competition, manage stock effectively and, for the benefit of all units, communicate important information to their franchisor. As noted by the Managing Director, owners-managers were regarded as more highly motivated than employee-managers to do these things:

*I mean they (owner-operators) are there in their environments 24 hours a day, so they can have an intimate knowledge of the local market and what their competitors are doing or not doing... and they have got more of a vested interest in doing those things... passing them on (information to the franchisor), certainly, and those sorts of things - much more so in that [owner-manager situation] than the likes of a managed structure would, or we could ever hope to do from a centralised position.*

A recent attempt to improve system-wide efficiencies reaffirmed the need for motivated store managers, but also added the importance of maintaining a direct relationship with individual stores. The new initiative involved centralising a larger proportion of stock purchasing. The Managing Director said:

*Just with the changing in the market and the introduction of new people and more competitors in the business, we had to reassess that and change to make sure we are leveraging our buying volumes.*

Franchisor executives felt that maintaining a direct relationship with individual stores

provided more effective communication of stock requirements and information. By comparison, franchisor executives thought that forms, such as area representation and subfranchising, which involve the addition of master franchisees, would make centralised purchasing more difficult; it would be more complex administratively and take more time. Summing up his views, the Managing Director said:

*The practicalities of managing that (centralised purchasing) we saw as being an issue and a problem with those (area representation and subfranchising).*

The desire to maintain and improve both store performance and system-wide efficiencies influenced SportCo's form choice. As identified above, achieving both requires diligent store management and benefits from a direct relationship. Informants regarded single-unit franchising as the most appropriate franchising form in this context. By contrast, direct multi-unit forms reduce store manager motivation by involving employee-managers rather than owner-managers, while indirect forms impede efficient communication by involving master franchisees. Therefore, single unit franchising was the preferred option.

### ***Customer Diversity***

Demand for sporting goods was quite heterogeneous. Further, it was heterogeneous both within and across different store territories. Within store areas, for example, informants said that customers' wants, needs, preferences and tastes varied considerably. Across territories, heterogeneity was compounded as individual locations featured unique demographics, climate, location to activities, sporting interests, wildlife and so on. This heterogeneity meant that store-managers must adapt their stock to local demand. Illustrating differences between stores, the Managing Director noted:

*Because of the climate variation the jackets sell better in the South Island than they do at the top of the North Island - so you have got climatic variations in the apparel we sell. There is in variation in fishing throughout the country and that is more to do with the type of fish, because there is variation - you get salmon here but you don't get tuna down there, so it is the reflection of that. But I mean, tennis, golf, cricket, footwear - footwear, a little bit, because South Islanders are a bit more outdoors-in-the-mountains-walking-type-orientated but like outdoor and*

*hiking shoes sell better. Touch (touch rugby) is comparatively stronger in the Auckland market so touch shoes sell better there.*

All informants said that store managers must be highly motivated to effectively adapt their stock to local customers. As the Managing Director said, this motivation is required because the tasks associated with purchasing the right stock in the right quantities is immense:

*The buying part is probably the most demanding part of our business because of the number of products, the fragmentation or diversity which is everyone is, and each market is a little bit different too because there are different targets, you know. The type of person that buys golf gear can be a different type of person [to someone] that buys cricket gear or buys fishing gear or buys footwear or buys apparel, and within footwear you have different markets with a person who buys a suede type street shoe is quite different from the person that buys the running shoes. So there is a lot of different markets that the franchisee has to come to grips too in terms of trying to deliver the right products at the right price at the right time and in the right quantities. So even for a experienced franchisee that part of the business is still quite demanding. There is no real short cuts to it all, so it helps with the local involvement (Managing Director).*

The variation of demand within and between stores influence form choice by highlighting the need for highly motivated store managers. Single-unit franchising was preferred because it preserved owner-involvement in stores. Indeed, all informants (including the franchisee) noted that having owners involved in stores, as opposed to salaried managers, meant that stores perform more effectively in this diversity. The importance of owner-involvement is illustrated in the following quotations:

*Stockholdings and buying are completely different between Queenstown and Whangarei. Our people can get up to 50% more sales from a store than we could if there was a manager in there and the head office was doing all the buying. They (the franchisees) can buy what the market wants (Founder).*

*That is the other good thing about having the owners in stores. I mean they are in tune with their own local area. You can react to or respond to your customers. Just having somebody who has the enthusiasm and the drive, you know, because they are sharing the rewards at the end of the day, so it does make a difference (Franchisee).*

Consequently, single-unit franchising was preferred in this context of heterogeneous demand.

### ***Managerial Complexity***

A striking feature of this case was the high level of complexity associated with managing an individual SportCo store. This complexity derived from four key sources. First, the product line was large. While the franchisor specified a minimum range of around 1500 different items, stores actually stocked between 2000 and 7000. Second, demand was diverse. Store managers needed to understand the wants, preferences and tastes of diverse customers. These two sources of complexity meant that activities associated with stock management, such as buying the right products, in the right quantities (not to mention charging the right price), were highly challenging. Third, there were numerous suppliers to deal with. Most had around 100 suppliers; the franchisee I interviewed had more than 150. Fourth, and finally, store-operators needed to recruit, train and manage staff, including sales people. SportCo stores employ up to eight full-time and 10 part-time staff.

Franchisor executives and franchisees alike acknowledged that their stores were complex operations to manage. Indicative of this complexity, the founder and franchisee noted it took two to three years for the average operator to become capable of managing a store. Furthermore, as the following quotations made by the franchisee illustrate, the wide range of activities coupled with the number of tasks to perform meant that individual stores were very time-consuming to manage:

*There are so many suppliers [and] so many different product lines, you know, and then having to do the accounting and the book-work side of things, making sure that what you are paying for is what you are getting. You might be the best salesman in the world but you could be losing it out the back door. I mean staff*

*theft, shoplifting, I mean there are so many avenues that you have got to keep your mind focused on (Franchisee).*

*It is complex because you have got so many things coming at you in different angles. I mean you have got all your book work side of things, you have almost got to be a baby sitter too because you are dealing with your staff and their personal problems and aspirations and all their pitfalls and everything else. Then you have got your suppliers. You have got to play one supplier off against another. You have got to look at what products you have. [You have] got to compare all the different product ranges and make your decisions from those, and then, to top it off, you have got to deal with the customer, which is most probably the most important thing out of the whole lot (Franchisee).*

The complexity of store operations highlighted two areas in relation to franchising form choice, namely having motivated store managers and quality franchisee selection. Given the high level of managerial complexity, all informants emphasised the importance of having motivated managers operating SportCo's stores. Furthermore, all informants (including the franchisee) also said they felt owner-operators were, in general, more motivated than employee-managers to effectively manage the complexity. For example, the Managing Director stated:

*I mean the difference with the franchisees is it is their money. So that is great motivation to make sure you know that the bookkeeping and keeping all that part of the thing balanced and all those sorts of things which are greater than with an employee. And I mean obviously you have got to think from a franchisor's perspective that we don't have to worry about it directly because it is their business. While we do care, we don't necessarily have that direct worry or whatever supposed to if they were company-owned stores and we were paying the bills.*

The founder also added, in a follow-up call, a further advantage of having owner-managers. The founder said that owner-managers, because of the investment they had made, were likely to manage stores for several years. By contrast, the turnover of



employee-managers was much higher. Therefore, the founder said that, due to the time required to learn the business, it helped to have owners managing stores. In relation to recruitment quality, the founder illustrated the importance of care and attention during the selection process. He preferred that the franchisor organisation maintain control of recruiting franchisees. Furthermore, the founder and managing director personally controlled all franchisee recruitment decisions.

Overall, franchisor executives preferred single-unit franchising. Given the level of managerial complexity, single-unit franchising was advantageous because it maintained control of franchisee selection and provided owner-operating store managers who were motivated and able to manage their stores effectively.

### **Summary**

Founded in 1964, SportCo comprised a network of 50 stores retailing sporting goods throughout New Zealand. Notwithstanding some exceptions, SportCo's form was largely characteristic of single-unit franchising. SportCo started franchising in 1982. From this date until the present day the network has grown from eight company stores to 50 franchised stores. A number of factors influenced SportCo's form selection. Two factors stood out, namely incentives and franchisee ambition.

Incentives strongly influenced SportCo's selection of single-unit franchising. All informants (including the franchisee) believed ownership provided store managers with motivational incentives to perform more diligently than any employee-based compensation plan. That belief led to a preference for single-unit franchising over direct multi-unit forms. Incentives also further impacted on form by influencing the structure of franchisee expansion. In rare instances where franchisee expansion was permitted the FPS was preferred to sequential franchising and area development because it provided owner-involvement in additional stores. Franchisee ambition, the second factor, influenced the prevalence of multi-unit ownership. Franchisee desire and ambition, not their franchisor's, drove instances of franchisee expansion.

Franchising form choice was also influenced, to a varying extent, by factors representing

environmental and task uncertainties. Demand size had some influence on form choice. Limited demand meant few stores were required. This context highlighted the advantages of single-unit franchising compared to multi-unit forms, including maintaining efficiencies (unit-level and system-wide) and control. SportCo disregarded indirect forms, in particular, because they would not be financially viable given the market's size. SportCo's choice of form was also influenced, in a minor way, by the level of market growth. The recent plateau in growth focused franchisor attention on maintaining store-level productivity, reinforcing the choice, and continued prevalence, of single-unit franchising.

The dispersed nature of demand contributed to SportCo's utilisation of single-unit franchising. Single-unit franchising was preferred because it reduced problems associated with geographically isolated stores. Moreover, single-unit franchising reduced monitoring costs by providing owner-managers (or franchisees) who were more motivated, than employee-managers, to perform diligently.

Intense rivalry also influenced the selection of single-unit franchising. Single-unit franchising was preferred given the level of competition in this context because it maximised unit-level and system-wide efficiencies. These were achieved by maximising owner-involvement in stores and centralising franchisor related activities.

The diversity of customer wants and needs strongly influenced form choice. Demand for sporting goods was quite diverse within and across territories. This meant managers were needed that were motivated to attune stock with local customer needs, wants and preferences. SportCo preferred single-unit franchising because it provided diligent store managers who were more diligent, and therefore more responsive, to customer needs.

Finally, SportCo's choice of form was also strongly influenced by the level of managerial complexity associated with operating their stores. SportCo stores were complex and burdensome propositions to manage, thereby requiring highly motivated store managers. Single-unit franchising was preferred for those reasons. First, single-unit franchising involved owner-operators who made more diligent managers. Second, it enabled the franchisor to control store manager quality by centralising all store manager recruitment decisions. Third, because owner-operators featured lower levels of turnover, than that

associated with employee-managers, single-unit franchising ensured a higher overall level of experience in store-management positions.

## **CHAPTER 4**

### **CASE DESCRIPTIONS: DIRECT MULTI-UNIT FRANCHISING**

#### **Introduction**

This chapter presents descriptions of two companies employing direct multi-unit franchising, namely VideoCo and RealCo. The following chapter (Chapter 5) examines case studies of companies utilising indirect multi-unit franchising.

## VIDEOCO

### Background

Founded in 1990, VideoCo operates a video hire chain with 88 outlets located throughout New Zealand. Individual VideoCo outlets have between 4000 and 15000 video titles available for member customers to hire. In addition, outlets hire a wide range of electronic games and consoles, and are beginning to offer Digital Video Disks (DVDs). VideoCo outlets also sell a small range of soft drinks and confectionery.

All 88 VideoCo outlets were franchised and arranged in a manner characteristic of sequential franchising. Seventy outlets were run by owner-operating franchisees. Multi-unit franchisees accounted for the remaining 18 outlets. Multi-unit franchisees held financial interests in between two and five outlets each. New franchisee expansion occurred on an incremental or sequential basis and the franchisor reserved the right to stop franchisees from establishing additional outlets. The franchisor had no criteria specified for pausing or blocking franchisee expansion. The franchisor charged new franchisees an initial fee as well as an ongoing royalty based on sales for right to operate a VideoCo outlet in an exclusive territory.

VideoCo's franchisor office was located in Auckland and the team comprised a general manager, marketing manager, purchasing manager/IT manager and business development manager. There were also three salaried regional managers that provided support directly to individual outlets. One serviced outlets in the South Island and Wellington (North Island). The second supported outlets from north of Wellington to Auckland. The third supported outlets north of Auckland.

The franchisor provided franchisees with wide-ranging support. Regional managers visited outlets regularly and offered franchisees assistance with local marketing, business plans, staff issues, and so on. The franchisor also provided franchisees with extensive purchasing support. The franchisor negotiated with distributors centrally and purchased videos and electronic games for all stores. The franchisor further assisted franchisees with purchasing by generating specific buying schedules for each individual outlet. The franchisor also

helped by organising regular regional meetings and an annual conference. All meetings and conferences involved franchisees, regional managers and selected head office franchisor representatives.

## **Development**

The VideoCo franchise system developed from a buying group comprising more than 30 independently owned and branded video outlets in 1990. VideoCo's founders formed the buying group during the late 1980s to improve purchasing in an environment dominated by powerful movie distributors. The BDM noted the extent of distributors power:

*It was even to a point where they would tell retailers where they could and couldn't open video shops. It was very very dominated by movie distributors right in the early days.*

The buying group was a success and by 1990 it comprised 35 independently branded outlets. Bargaining as a group meant that members were able to obtain benefits from distributors, such as discounts and free promotional items, which could not have been achieved by purchasing independently.

While the group met purchasing objectives, it failed to capitalise on advantages in other areas, especially marketing. As stated by the BDM, other possibilities could not be explored because the buying group lacked a unified brand:

*So it (the buying group) was quite a successful way of operating. But what they (the founders) had created for themselves was a way to be a bit more proactive when it came to purchasing their product and making decisions on product placement and doing deals on pricing and so forth, but they didn't have anything to market because every shop had its own brand. So there was no [unified brand].*

With new knowledge of franchising and its growth overseas, the founders decided to develop another group with a single brand and organise it as a franchise system. The founders believed a franchise system, compared to the co-operative buying group,

provided a more formalised structure to obtain a broader range of advantages. The VideoCo franchise system and brand was launched in 1990, and 30 outlets from the buying group, including 10 owned by the founders, joined the franchise system.

The franchise system provided franchisees with more rigorous standards and not all franchisees, that had previously been buying group members, were comfortable with the reduction in autonomy. In fact, the BDM said that some franchisees were so unhappy with increased control over their businesses that they decided leave VideoCo when their agreements expired:

*In that first four years - because they were four year franchise agreements - there was a lot of learning for all parties; not only from us as the franchisor, but for franchisees as well, getting use to someone else having more control over their business and some of them didn't like it very much. So at the end of the four year period there would have been probably half a dozen or so that actually pulled the pin at that stage.*

The first four years of franchising also produced other problems. The founders attempted to simultaneously perform all franchisor duties whilst operating 10 video outlets, and the heavy workload limited their ability to manage the franchise system effectively. Consequently, the BDM said:

*They didn't go a lot further than they had been with the buying group, apart from the fact they had a brand name and then they started to do promotions with that brand name.*

Franchisees that renewed their agreements with VideoCo, after the first four years, called for more professional organisation. Some also, as the BDM said, had been concerned that the founders had a conflict of interest by being franchisor and owning outlets:

*A lot of the people that stayed said well OK we quite like where this is going but we want it to be more professional and the two owners of the company had struggled with that... By this stage they had 10 of their own shops. So they were*

*trying to run the franchise company and their ten shops as one entity and it just wasn't working, and there were questions of conflict of interest and all those kinds of things.*

An unusual situation then emerged whereby the founders removed themselves from the franchisor organisation in order to concentrate on operating their outlets. In 1995, the founders established a professional management team to manage the franchisor company. Except for directorships, the founders ceased their involvement in franchisor operations. After one year, the founders withdrew further from franchisor operations by exiting the board of directors. The founders then signed separate franchise agreements for each of their outlets and became franchisees.

Under the new management team VideoCo grew to comprise 88 outlets by 2000. Growth involved a combination of new and existing franchisee expansion. Recently, some multi-outlet franchisees reduced the size of their holdings. In most cases these outlets have been purchased by new franchisees.

### **Franchise Imperatives**

The decision to franchise operations was influenced by the need for standardisation. The founders wanted a formal structure in which they could establish a single brand and obtain efficiencies in marketing as well as purchasing. The founders perceived franchising as advantageous, compared to the co-operative styled arrangement used for the buying group, because it involved a more formalised structure with clearer leadership.

VideoCo's choice of franchising form was influenced by two key factors, namely franchisee ambition and control. In terms of franchisee ambition, some initial franchisees already desired and had multiple-outlets before they joined VideoCo from the buying group. Further, as stated by the BDM, some sought to expand their personal network further:

*In some instances the franchisees had more than one video store before they joined the group. The Dunedin franchise, for instance, was very much like that where they have got four shops, three of which they had before they became part of VideoCo,*



*and then the fourth one they have opened since they bought a new franchise area since then.*

Some new franchisees were also ambitious and desired additional franchises. As the BDM said, the franchisor typically granted additional franchises to such franchisees with little resistance:

*[A]s long as we are happy with the business they are running then we don't have a problem with allowing them to take on another franchise. From time to time we have put conditions in place. I recall requiring a refit of an existing store before you invest in a new store simply because you have got a shop that is due for a refit and it is starting to look a bit tired and we don't want people to take all of their money and invest it into a new business and then they have got nothing left to refit the old one. So we have done that from time to time.*

Interestingly, the franchisors view on multi-unit ownership altered with experience. The BDM said multi-unit franchisees were more powerful and difficult to manage than single-unit operators. Consequently, if VideoCo were to franchise again, franchisee expansion might be limited:

*One of the difficulties we have come across with our franchisees that have multiple outlets is that they can be more difficult to manage because there is a perception that they have got two or three shops and that they perceive themselves to be worth more than a guy that has got one shop and so it can actually create difficulties in its self and you only need two or three franchisees that have got multiple outlets to get together and they become a very strong lobby group and that creates a difficulty in management and that is one area that we would probably look at a lot more carefully next time.*

VideoCo's choice of sequential franchising over area development, area representation and subfranchising was influenced most by a concern for control. The BDM felt that each of these alternative-franchising forms compromised control to an unacceptable level. For example, sequential franchising was preferred to area development because it maintained

greater control over the development of outlets. The BDM said that area development reduced franchisor control over expansion and could lead to slower system growth:

*It is not really the way we would want to do it. We would prefer to keep control over it. We might from time to time give a franchisee first rights over a neighboring territory if they are looking to expand, but we wouldn't give someone a big territory and say go for it... I would feel that we tend to lose control over the development of that territory simply because the person that was given that opportunity could take five years to develop four shops whereas if we take control over that we can probably do it in half that time.*

The franchisor also preferred sequential franchising to area representation and subfranchising for reasons relating to control. The BDM felt that the franchisor delegating responsibilities associated with franchise recruitment and support to area representatives or subfranchisors would reduce the quality of franchisees recruited and support provided thereafter. Furthermore, the BDM reasoned that the basis for area representative or subfranchisor remuneration increased the potential for control loss in these areas:

*It is really about the control mechanism for that person there. I think that is possibly the question that crops up. Are they going to act in the way you wish and they might have a vetted interest in just getting as many franchisees as possible and you end up with quantity but not quality.*

By contrast, the BDM believed that the sequential franchising form was more appropriate. He felt that centralising franchisor-related activities, such as franchise recruitment and support, increased the likelihood each function would be performed to an acceptable standard. Furthermore, the BDM said it was more beneficial having salaried regional managers, hired by the franchisor, than area representatives or subfranchisors whose remuneration is tied to the performance of their territories:

*I mean they (regional managers) are salaried employees and, as such, they are not responsible to generate their own revenue. They are purely a support person... I think we are better off in the system we have got now.*

## The Environment

### *Market Size*

The BDM felt that sequential franchising was the most appropriate franchising form for VideoCo given their market size. Furthermore, he said that even if the market were much greater in size, VideoCo would continue to prefer sequential franchising to alternative types of franchising. For example, if the market size was doubled, the BDM said the following about area development:

*We would still like to be in control of every single shop and even if they are two or three of them owned by the same franchisee we would want individual control over each shop. So yes, I think we would tend to shy away from that one there which is area development.*

The BDM also said that VideoCo would continue to prefer sequential franchising to area representation and subfranchising, even if the market size was doubled. He reasoned that the existing form could cope easily with managing many more outlets:

*I think with twice the number of outlets we would even find ourselves more efficient. One of the difficulties we have got now is with three field managers they have a lot of territory to cover and if you can afford to have more and they can specialise in the area then they become more efficient. And in the same way, the way that we operate within the office here, there is a lot of what we do here that wouldn't change if we doubled the number of size. So I guess there is physically more paper and reports and that kind of thing but the way that we go about our purchasing would still be the same, and in the same way we would have more field staff out there. But they would still be doing the job in the same way and the profits would be greater then, simply because doubling the size of the whole thing doesn't double everyone's workload.*

Consequently, the size of demand had little influence on VideoCo's choice of form.

### **Market Growth**

Historically, growth in demand for hiring videos has been strong. In particular, demand grew rapidly during the 1980s and early 1990s. More recently, by contrast, informants said that growth in market demand has peaked. For example, the BDM stated:

*[Excluding the last 12 months] you would be talking around 15% steady growth. So excluding probably the last 12 months, we have stayed pretty well stagnant... The industry is pretty much the same. We have got no reason to feel that we are any different from the rest of the industry.*

The regional manager concurred with the BDM's view and added there had been a rapid increase in the range and popularity of alternative activities:

*You have got rugby to start with: The Super 12 has become huge. Cinemas have picked up a huge amount. Really just more things to spend your money on, and you have got Sky TV, and all that.*

The context of earlier rapid market growth and the more recent context of low or negative market growth influenced form choice differently. During the period of earlier and more market rapid growth, existing franchisees were more inclined to seek and establish additional outlets. This led to a high proportion of outlets owned by multi-unit franchisees. More recently, by contrast, lower market growth has reduced the inclination for existing franchisees to expand the size of their networks. Furthermore, as stated by the BDM, lower market growth has led many existing multi-outlet franchisees to actually reduce the size of their networks, and pursue alternative opportunities outside of the sector:

*The earlier part our franchise has grown from existing and new video shop owners, but our growth over the last couple of years has seen quite a number of new people coming into the industry, and we are also seeing, over the last 18 months, more businesses changing hands as well. So we are getting new people in. Whereas somebody might have owned that video shop for five years, now they are looking to do something else, change or whatever. A few of them maybe just nervous about the lack of growth over the last 12 months, after seeing it very*

*healthy over a number of years, then all of a sudden it stops, and think well maybe this the time I should get out...For instance, our Invercargill franchisee had three shops; [he] had two in Invercargill and one up in Gore, and he has sold off the one in Gore and the one in Invercargill and retained one himself and invested in other business ventures.*

The increasing number of new franchisees, due to decreasing market growth, also influenced form choice. As indicated above, the BDM related an increased proportion of new to experienced franchisees to the downturn in demand growth. In turn, he said that those new franchisees require greater support:

*One thing that we are seeing demand for is the services for the field managers. It is possibly because we have got people who are new to the industry coming in.*

The increase in support required, for the increased number of inexperienced franchisees, highlighted disadvantages associated with the area representation type of franchising. The BDM said in relation to the recent downturn in demand growth:

*So then you get the new people coming in who don't have the experience and that's why we do have requirements there for the field manager to be able to go in and spend time with those people. So this is where these other ones, where area representation, they become less inclined to do that - less inclined to go and spend a day or two days in a shop and more interested in getting people on board.*

In summary, market growth influenced VideoCo form choice. Earlier and more rapid market growth led to the creation and growth of multi-outlet franchisees. By contrast, more recent low or negative demand growth contributed to many multi-outlet franchisees reducing the size of their holdings. In turn, a combination of lower demand growth, and a greater proportion of new operators, increased the need for franchisee support. This influenced franchising form choice by highlighting disadvantages associated with area representation.

### ***Customer Dispersion***

Customer demand for video hire was dispersed. Reflecting that dispersion, VideoCo had 88 outlets in towns and cities throughout New Zealand. The level of dispersion did not influence VideoCo's choice of franchising form. Due to their path to franchising, VideoCo was able to establish dispersed outlets from the outset, with little difficulty. More specifically, recruiting franchisees directly from the buying group provided VideoCo with a ready dispersed network of video outlets. Consequently, the BDM said:

*I don't think it (customer dispersion) does [influence choice of form] because the spread of shops was there right from the beginning. So when they moved from a buying group into franchising they were already dealing with people in Dunedin and Invercargill and right throughout the country.*

Had circumstances been different, however, the BDM said that the level of customer dispersion could have influenced form choice:

*So if we had been a franchise that started as an entity in Auckland and then spread, maybe it might have been different. Maybe we would have started to look at things like subfranchising or regional representation (area representation), but it wasn't the way that our business developed.*

However, while the BDM noted indirect forms, namely area representation and subfranchising, were more attractive with dispersed demand, sequential franchising was still preferred. The BDM wanted to maintain direct control of individual outlets:

*There is always the concern that [with] those - area representation [and] subfranchising - of losing control. That is the one thing that would be of a concern.*

## **Competition**

Competition has intensified. Early on competition was sparse and pioneering operators, like VideoCo's founders, were able to build sales and additional outlets with relative ease. Now, in contrast, the sector is much more highly populated. Contrasting these different periods, the Regional Manager stated:

*Back in the 'hay day' of video - I mean if you go back 10 years - it is a license to print money. Well nothing like nowadays. It is like any industry, when there are a few stores you are making a fortune and when there is a million stores you are not. You could have had a monkey owning a video store 10-15 years ago and they would have made millions. But it doesn't happen that way now.*

Increased rivalry adversely affected outlet performance. In particular, margins were diminished due to price competition, the introduction of loyalty programmes and extended rental periods. In response, many smaller competing networks have disbanded and some outlets have closed. VideoCo experienced higher franchisee turnover due to increased nervousness regarding the sector's long-term outlook.

VideoCo's form was influenced by competition. Competition added to concern about the sector's longer-term prospects that, in turn, contributed to many multi-outlet franchisees decreasing the size of their holdings. Multi-outlet franchisees sold outlets to new franchisees, which increased the proportion of outlets held by single-unit franchisees.

Competition also influenced VideoCo's feelings toward area representation, by highlighting the importance of franchisee support. The BDM said greater competition increased the need for franchisee support:

*When you have got a fair amount of competition there is more demand for that regional manager role because they (the franchisees) are always looking for help to keep their turnover up. If the competitor has run a promotion they want to do something as well, so it becomes quite important for them to be able to have some assistance and advice from us, whereas if everything is going fine and we'll see that quite often where we have got a shop in a regional town and they are left by*

*themselves and they are quite happy they don't want any help and we'll suggest some ways to improve their business and they are not really that interested and all of a sudden a competitor comes into town and a total mind shift [happens]. So competition does create that need for support and that is why they are part of a franchise.*

In relation to form choice, the BDM felt that it was better to operate a form where the franchisor controls the provision of franchisee support. He believed that providing this function directly ensured franchisees received quality support. By contrast, the BDM said he felt area representatives lacked incentives that would motivate them to provide good franchisee support:

*I think it goes back to that point where the regional manager becomes a lot more responsive than maybe an area representative, because as far as he (the regional manager) is concerned, he is just operating a service to franchisees. He is not trying to create revenue.*

### **Customer Diversity**

Demand in the video rental market was moderately heterogeneous. Customer needs, wants and preferences varied within and across locations. Contrasts most often compared wealthy-and-well-educated versus poor-and-uneducated populations. Outlets catering to either population required a different composition of stock. Yet, while there was variation this affected a relatively small proportion of stock. For example, both the franchisee and BDM stated:

*You buy what is sort of middle of the road or if you find in your area that they are more inclined to martial arts or wrestling or and you buy a few more of those than say you would in another area where you might buy more drama or art festival type movies. So you have your general new releases which are going to satisfy everybody down the middle, but you will have your fringe movies that you can buy. It is up to your own discretion (Franchisee).*



*Your main hit movies are the same everywhere, whether it is 'The Truman Show' or 'Saving Private Ryan,' every shop is going to have those movies. Because they have generated their own publicity, they will rent everywhere (Business Development Manager).*

This heterogeneity had little impact on outlet operations. While stock composition differed between outlets, all informants noted that the task of selecting stock was relatively easy. For example, the franchisee stated:

*Generally movie people want to see the new release ones so everybody will be getting those. Everybody gets 'Titanic' and things like that, so it's the ones on the outside: Do I buy two wrestling ones this month or do I buy two art festival ones or what little niches do I need to accommodate? You get the feel of it. After a while people come in and ask for certain types of movies. Like when I came here, they (the previous owners) had wrestling movies but they just had a few older ones. But I had people asking for them, so now I get two new new release wrestling movies each month.*

The BDM did not think the diversity of demand influenced the choice of franchising form:

*I don't think so because it essentially is still the same business. There is just a variation in the product to suit and it is not huge because the main titles are still the new titles that are renting.*

### ***Managerial Complexity***

Informants all believed VideoCo outlets were not complex operations to manage. While outlets carried between 4000 and 15000 videos and 700 games for rental, the tasks associated with stock management were not complex. New video releases arrived at a rate of between two and seven per week, and operators quickly learnt how many to order. The purchasing manager also assisted this process by supplying franchisees with detailed buying schedules based on their outlet's circumstances. The purchasing manager also arranged deals with most suppliers directly, obviating the need for franchisee participation

in multiple, lengthy and sometimes complex negotiations. The BDM said:

*So the purchasing manager gets the monthly buying catalogue from all of those people (distributors) and negotiates on the right price for all the top titles. Then we create a buying schedule for each of our franchisees and give them a budget based on their sales and turnover and we issue them out, and in its most simplest form we can actually create the order for those franchisees. They don't even have to make any decisions about what to order.*

Deals with confectionery and soft drink suppliers were also typically arranged by the franchisor. Further, as the BDM said, these items were often vendor managed:

*A lot of that stuff (confectionery and soft drinks) is 'vendor stock' or 'van sales.' The Coca Cola truck comes around and they buy two crates off him, so it all just happens basically. The ice cream truck comes around and the guy checks the fridge and says, 'oh you need some more of those and some more of those'... so they don't have to make too many decisions.*

Product placement and pricing decisions were relatively simple and routine. For example, new titles are priced high and added to the 'New Releases' section. With age these move to the 'Recent Releases' section. Following this, they are placed into descriptive categories, such as 'Action,' 'Drama' or 'Horror.' Hiring costs decrease at each stage. Using a proprietary computer system, outlet managers monitor the performance of each video. This assists decisions on pricing, placement, and selling of unwanted stock.

While informants described the aforementioned tasks as relatively simple and uncomplicated, all agreed that responsibilities associated with staff management were more complex. Operating a medium-sized outlet, the franchisee interviewed employs three full-time and three part-time staff.

Overall, as indicated above, the outlets were considered relatively easy to manage. In particular, they were considered much easier to manage than a traditional retailer, such as SportCo. For example, the Regional Manager stated:

*See video rental is a sort of retailing but it is not, because you have not got all that dead stock that retailers have. You don't have to anticipate six months ahead for the next season [and] it is not like food where you have got to bring in different regulations and all that sort of thing. It is a very easy business to run...I mean [in Video hire] you buy a product, sell it, it comes back the next day and you sell it again, it comes back the next day and you sell it again.*

Initially, the BDM did not think the level of managerial complexity influenced VideoCo's choice of franchising form:

*No, I guess it doesn't, because it is the type of business that attracts people who don't really have too many skills and because the franchisor provides the support and if he didn't provide the support then you wouldn't attract those people. I think of it in the same way as Pizza Haven (a pizza delivery company) or someone like that, because they take people that have just got some money to invest and they train them into the business and then they support them by helping with all the promotions and so forth.*

The BDM conceded, however, that the simplicity of managing a VideoCo outlet does make it easier, compared to some more complex retail formats, for skilled franchisees to successfully establish and manage multiple outlets:

*Yes it is [easier], providing that they have got the skills to do it. [However] it is very easy to think because you run one business very well that you can then go to two. Because with one business you might be spending a lot of time in the business and as soon as you have got two then you are not doing that... So it doesn't go hand and hand.*

## **Summary**

Founded in 1990, VideoCo comprised 88 franchised outlets dispersed throughout New Zealand. VideoCo developed from a co-operative buying group when the founders

perceived advantages of a more formal (franchised) network, encompassing a unified brand. Thirty outlets were converted to franchises in the process. VideoCo's form was characteristic of sequential franchising. Around 20 percent of outlets were controlled by multi-unit franchisees. The largest had five. Some multi-unit holdings were established during the conversion process. Subsequently, some new and existing franchisees added further units. Recently, franchisee turnover has increased and some multi-outlet franchisees have reduced the size of their networks.

The utilisation of sequential franchising was influenced by franchisee ambition. Sequential franchising occurred as some existing multi-unit franchisees and new franchisees had aspirations to establish and own additional VideoCo outlets. The franchisor provided little resistance to such requests from franchisees to expand. Therefore the ambition of franchisees was able to influence VideoCo's choice of form.

The franchisor's need for control also influenced VideoCo's selection of sequential franchising. Sequential franchising was preferred to area development because it involved the franchisor maintaining control over the development of each and every outlet. Sequential franchising was also favoured to area representation and subfranchising for control-related reasons. The franchisor preferred sequential franchising because it retained direct control of franchisor-related tasks, such as franchisee recruitment and support. Importantly, the preference for sequential franchising compared to area representation and subfranchising, was also influenced by the perceived effect of different structures of remuneration. The franchisor was concerned that the structure of remuneration for area representatives and subfranchisors would motivate them to maximise outlet-growth at the expense of providing quality franchisee recruitment and support.

Environmental factors, demand size, growth, dispersion and heterogeneity, intensity of rivalry and managerial complexity had a less notable or negligible affect on VideoCo's choice of franchising form. Demand size had no influence on VideoCo's selection of sequential franchising. Even if the market size demand were much greater, VideoCo would continue to utilise sequential franchising.

Demand growth did influence VideoCo's form. During strong market growth early in

VideoCo's development, a number of franchisees sought additional VideoCo outlets. In contrast, a recent plateau in market growth led to a subtle change in the extent of multi-unit franchising. Many multi-unit franchisees decided to sell some of their outlets, often to new franchisees. The sale of outlets by multi-unit franchisees then increased the proportion of outlets controlled by single-unit franchisees. The increase in number of new and inexperienced franchisees also influenced form choice, by highlighting disadvantages associated with area representation. A greater number of new franchisees increased the importance of providing quality franchisee support. Sequential franchising was preferred to area representation because it was believed to provide better franchisee support.

VideoCo's choice of franchising form was not influenced by the dispersion of customers. The conversion from buying group to franchise system provided VideoCo with dispersed outlets from the outset, thereby reducing the challenge associated with establishing outlets in locations isolated from the franchisor.

Competition had a minor influence on VideoCo's form. Increased competition and an associated nervousness regarding the sector's outlook, contributed to a reduction in the extent of multi-unit franchising at VideoCo. The affect of greater competition on outlet performance, and a larger proportion of new franchisees, increased the need for quality franchisee support. The need for quality support, in turn, also influenced form choice by highlighting disadvantages associated with area representation.

Finally, the diversity of customers had no notable influence on VideoCo's choice of form. The level of managerial complexity also had little influence on VideoCo's choice of form. However, it was noted that simplicity of operating a VideoCo outlet, compared to more complex retail formats, does make it easier to establish and manage multiple outlets.

## REALCO

### Background

RealCo is a real estate company with 145 offices located throughout New Zealand. Together these offices employ more than 1500 real estate consultants/agents with sales in excess of four billion dollars annually. On average, each office had around 10 consultants, but ranged from less than five to more than 40. This case centres on RealCo's primary focus, which is residential and rural property sales in New Zealand. Using separate entities, RealCo also offered a range of other related services, including commercial sales, leasing, property management, mortgage lending and insurance. RealCo also had international interests, with a franchise network comprising 45 offices in Queensland, Australia. The range of related services and the Australian office network are both beyond the scope of this case.

RealCo's form comprises a blend of sequential franchising and area development, and all offices were franchised. Characteristic of sequential franchising, some franchisees have grown personal networks on an incremental basis, with each additional office requiring separate franchisor approval. Area development has occurred in two ways. First, all franchises comprise an exclusive territory within which owners can establish multiple offices at will. Second, some owners have been granted multiple franchises from the outset. This often occurred where RealCo purchased a competing multi-office networks before on-selling them to one or more multi-unit franchisee/s. RealCo's 145 offices are currently controlled by 70 franchisees. While some single-unit franchisees exist, many franchise owners have more than one office. Multi-unit franchisees have between two and five offices.

New franchise owners were typically required to pay the franchisor an initial fee to become franchisees. Franchisees then pay the franchisor an ongoing royalty fee based on commissions received. Multi-office franchisees qualified for a royalty rebate based on size. In return for both payments, the franchisor provided franchisees with overarching chain management and support. The franchisor provided some services from a central location. Remaining franchisor-related services were provided via four regional offices

located in other centres throughout the New Zealand. The RealCo franchise management team consisted of more than 15 employees, excluding secretarial and administrative staff. This management team provided co-ordination, training, business consulting services and general support to local franchisees.

Sales consultants were recruited by, and affiliated with, individual real estate offices. However, all consultants contract directly with the franchisor. Following recruitment, all sales consultants were trained by the franchisor before operating.

### **Development**

The first RealCo office was established in Wellington in 1888. Growth from this time occurred in two distinct stages. The first stage/period lasted almost a century and was characterised by slow, incremental development. During this time RealCo grew to consist of eight company-owned offices. The second period was characterised by very rapid growth. This began almost one hundred years later, in 1985, after RealCo merged with another small, independent real estate network. Branded RealCo, the new company comprised 14 real estate offices.

From 1985, the new company (still named RealCo) embarked on an ambitious growth strategy with the objective of establishing a nation-wide network of offices. To achieve this goal, external capital was sought and obtained in exchange for RealCo shares. A local bank purchased these shares in 1986. In 1990, an insurance company purchased that holding and, in 1992, three RealCo executives staged a management buyout. The three executives were key instigators of expansion plans, after joining RealCo in the 1985 merger. The three managers now comprise RealCo's Managing Director, General Manager, and Chief Financial Officer.

The capital injected in 1986 helped fuel RealCo's expansion from 14 to almost 100 real estate offices by 1990. Expansion was achieved using two modes of company-owned development. The first, and preferred method, involved purchasing existing, independent offices and networks. The second involved RealCo establishing new offices. RealCo

focused initially on penetrating large populations centres, such as Auckland, Wellington and Christchurch, before entering smaller cities and large towns.

Franchise development began in 1990. From this day, existing company-owned offices were converted to franchises. New franchise expansion then grew RealCo to 145 offices by 1996. The process of conversion and new franchise expansion produced franchise arrangements characteristic of both sequential franchising and area development.

Considerable consolidation in franchisee holdings took place. At one time the RealCo network of offices was controlled by 114 separate franchisees. By contrast, 70 franchisees controlled a similar number of offices at the time of the research. The consolidation occurred as ambitious franchisees purchased offices from others either struggling financially and/or looking to leave RealCo. At the time of data collection, RealCo had amended their franchise strategy and sought to limit and reduce multi-unit franchisee expansion and size.

### ***Franchise Imperatives***

RealCo's choice of franchising types was influenced by a number of factors. Of these factors, incentives influenced two areas of RealCo's franchise development. In the first area, the issue of incentives influenced the initial decision to franchise. Prior to franchising RealCo shareholders were realising low returns on their investment, due to poor office productivity and profitability. Pressure existed to improve this situation and franchising was believed to offer a solution. It was felt that managers would operate more diligently as franchisees than employees. This belief proved correct and, as noted by the General Manager, office productivity and profitability improved remarkably:

*The cost of running a corporate structure probably halved when it was franchised, because the franchise owners owning their own businesses were far more particular in what they bought and ordered. So the costs reduced 50 percent, and because they owned the business the productivity went up 100 percent - so the net difference was incredible.*

Interestingly, incentives had a much greater affect than informants had initially imagined.



For example, when asked whether RealCo had expected such a dramatic improvement in performance, the General Manager stated:

*No we didn't, no. We thought there would be an improvement, but the improvement was to be so dramatic, as to be almost unbelievable.*

In the second area, consideration of incentives strongly influenced the decision to limit franchisee size. During the processes of expansion and consolidation of RealCo offices, numerous franchisees had established multiple offices. On average, the individual performance of offices associated with such networks proved to be poor, especially in comparison to single-unit franchise operations. Franchisor informants attributed this performance difference to the fact many offices owned by multi-unit franchisees were managed by employees. Consequently, as stated by the General Manager, this contributed to RealCo's decision to reduce and limit multi-unit franchisee size:

*Interestingly enough, we are now focusing on trying to get those larger franchise owners back, acquiring them or encouraging them to split up and disseminate the offices again, because the replication of the structure that we had wasn't profitable for us, and although it is profitable for the franchise owner, it is not maximising the return from the territory because you can never get a manager to produce what an owner will. So these bigger guys have got managers and they were like us, they have got under-performing managers overall. They make a profit out of sheer size, but when we look at it on an individual basis, the productivity per person and per office is abysmal. So now our focus is how do we break these big guys up and split them up.*

The initial decision to franchise was also influenced by access to financial capital. As stated by the General Manager, advantages in this area were initially associated with expansion into small, more isolated markets:

*It wasn't economic for us to set up an office in remote areas, so the franchising commenced with us wanting to spread the brand, and having an office related that we could refer business to and build a national company.*

However, it quickly became apparent that the access to capital provided by franchising was beneficial for expansion in other markets and reducing franchisor financial exposure in existing, company-owned offices.

Company manager, and later franchisee, aspirations also strongly influenced RealCo's franchising decisions. Prior to franchising, RealCo had few options available for extending talented and ambitious office managers. Consequently, many managers desirous of further development looked at opportunities outside of RealCo. This represented a twofold loss as RealCo faced losing competent staff, and long term rewards for their investment in manager training and development. As stated by the General Manager, franchising helped resolve this situation by providing office managers with greater opportunities:

*What we found was the managers that we had recruited, taught and trained running the company-owned offices were looking for the next step for them which was some form of business ownership. If we didn't provide some form of growth for those people they would have left and set up on their own. At that stage we started selling those company-owned offices and franchising them.*

Interestingly, while RealCo had been considering franchising for sometime, the first franchise sale occurred in direct response to one office manager's aspirations. Illustrating this, the Managing Director recounted the conversation that took place when the manager telephoned to inform him of his intention to join a franchised real estate company:

*I said 'well why would you want to do that' and he said 'well you would never have franchised a RealCo office' and I said 'who said?' and he said 'I did' and I said 'well you know \_\_\_\_\_ all then' and I said 'I'll see you in Featherstone in an hour.' So I got in the car and went over to Featherstone and we sat down and I said 'have you got the franchise agreement with you from 'Company X' and he said 'yes' and I said 'lets twink out 'Company X' and put in RealCo,' and that was our first franchise.*

The influence of franchisee aspirations on RealCo's decisions followed a similar pattern.

Ambitious individuals and/or partnerships were often not satisfied with owning and operating a single franchised office. Indeed, several franchisees sought to establish or purchase additional offices. Furthermore, they were prepared to leave RealCo if the franchisor did not grant them franchises. Illustrating the importance of franchisee ambition on franchisor decisions to grant additional outlets, the franchisor realised that allowing franchisee expansion could have negative consequences. The franchisor understood that allowing franchisee expansion could lead to increased franchisee power and lower office profitability, but was not prepared to refuse franchisee demands for risk of losing both competent franchisees and strategic locations. As noted in the following quotations, both franchisees and the franchisor acknowledged the strong influence of franchisee aspirations on RealCo's decision to grant franchisees multiple offices:

*Well people grow, and if they can't grow within your organisation they will pack up and grow somewhere else (Franchisee).*

*I believe we become successful by helping other people be successful. I believe if you put someone in one office who has the capability of running and owning and operating a bigger business successfully - if you stop them from doing that they will either kick the walls out and find a way to do it themselves, and then you lose them, and therefore you lose your top people, or they will sink down to a level of inactivity required to do what they are doing and they will lose the entrepreneurialism and the drive that made them successful anyway. So it is a lose-lose situation (Managing Director).*

*It is also ego. A lot of it [multi-office expansion] is driven by ego. Some [franchisees] want to be the biggest. Some want to be the best, [while] some just want to make a living, really. It is the personal goals of the individual (General Manager).*

RealCo's franchising decisions were also strongly influenced by the franchisor's desire for very rapid growth. As identified previously, franchising provided distinct benefits over company-owned development for facilitating growth. Notably, franchising provided superior access to capital by supplying franchisees with the managerial and financial

capacity to establish and manage additional offices. The desire for growth also influenced the types of franchising adopted. Following the decision to franchise, RealCo converted existing offices before continuing growth with new franchise expansion. RealCo pursued both activities with a level of urgency that focused more on producing growth than how it was achieved. Consequently, as franchisor informants described, a range of forms emerged:

*It grew as a piece meal. We just went for it. In other words, no serious thought [was given] to structure. What we knew is that when we had decided to do franchising - that was what we were going to do. I mean, I don't do second, so we just had to build and grow (Managing Director).*

*It was difficult to get successful operators to join, to put up a new brand and pay us a franchise fee. So we acquired shareholdings in a number of them, bought whole companies and franchised them afterwards, and generally we became a catalyst...For example, Taupo - one partner wanted out, so we took a shareholding and changed the name. We did that in a number of centers around New Zealand. So we were reasonably flexible in the way we engineered it, but the end result was a franchised company, even if we had a shareholding in it (General Manager).*

Flexibility in how growth was achieved was evident in the variety of organisational forms and ownership structure that developed. Accordingly, franchise arrangements characteristic of sequential franchising and area development all appeared; some involving franchisor equity. Such franchisee expansion was attractive to the franchisor because it facilitated growth. Specifically, allowing franchisees multiple-offices obviated the need to attract, select and establish new franchisees for each additional office.

Interestingly, however, subsequent experience with managing multi-office franchisees has made the franchisor more critical of earlier decisions. In particular, the franchisor now questions whether the long-term disadvantages associated with sequential franchising and area development, such as lower office performance and reduced control, outweigh the initial benefits produced by facilitating more rapid expansion. The General Manager reflected on this issue:

*If we franchised again, we would limit the number of offices per franchise owner. We wouldn't allow the aggregation of offices that has gone on, although hindsight is a wonderful thing. At the time when you are trying to build and you have got non-performing offices, and you are trying to get rid of them and there is a good franchise owner who wants to take it over - so you say, well we are getting nothing out of it so we are better off to get something. And once you establish, you know, the numbers then you look at it and say hey, you know, we really should break this up. But no, I think we would strive harder to find an independent owner to buy than just to persuade the existing franchise owner to take it.*

A desire for increased franchisor control over offices influenced decisions later in RealCo's development. In particular, the issue of control influenced RealCo's recent decision to reduce and limit the size of multi-unit franchisees. The General Manager said that as some franchisees have grown the base of power within RealCo had shifted from the franchisor toward such large multi-office franchisees. In turn, the shift in power had reduced the franchisor's ability to manage the chain effectively. The General Manager said tasks such as monitoring offices and implementing new initiatives became more difficult. In relation to new initiatives, for example, RealCo needed to take proposals for all new initiatives directly to an executive group comprising powerful franchisees. The General Manager said:

*Well we always present what our vision is to them first. If we get their buy in, we take it to the rest of the country. If they resist it then no, then we would change tack, re-package it, re-develop it, get the feed back and go back to them. If we don't have their mandate then we don't launch it to the rest of the country. So we have like an executive group that we take everything to first. If they buy-in, we go. If they don't, we don't.*

Underlying franchisee power was a threat of defection. The franchisor was concerned multi-office franchisees would leave RealCo to join or start competing operations. As illustrated by the General Manager, such defection was of strategic concern:

*A major issue is that if we had a large operation that left us, and either traded on their own, or took on another brand, it would leave a large dent in the organisation that we couldn't immediately fill.*

Consequently, the franchisor's decision to limit and reduce franchisee expansion was designed to reduce franchisee power and associated problems. In hindsight, RealCo considered one further strategy that might have been implemented to preserve greater franchisor power over offices and franchisees. As both the Managing Director and General Manager said, the franchisor could have taken a 50 percent share in important locations:

*If we had it again we would consider a 50-50 share in the city offices. The reason is, not for taking a profit, we get that from the fees, but the control side of things would have been better (General Manager).*

*I think if we were going to do it again – maybe in terms of the initial structure – we might have remained as silent 50 percent owners in each of the offices (Managing Director).*

## **The Environment**

### ***Market Size***

The market for real estate services is large. With around 90,000 houses sold per year, the market was sufficient in size for RealCo, and at least two other firms, to establish and operate more than 100 offices. The size of the market influenced the type of franchising RealCo adopted. As indicated in a previous quotation, allowing franchisees to establish multiple offices had been advantageous because it meant the franchisor did not have to recruit new franchisees for each individual office.

Franchisor informants also felt the market size influenced the extent of multi-unit franchising. For example, the General Manager said that if demand were smaller, multi-unit franchisees would continue to exist, but have fewer offices:

*The approach would be the same. You would still have the successful multi-office operators. They wouldn't have six offices, they would probably have three and your individual offices would shrink from four down to two. The model would still be the same. So it is really competency based. [Where] you have got a competent owner they will still have more offices.*

Finally, the market size also influenced the suitability of indirect forms, such as area representation and subfranchising. Both the Managing Director and General Manager thought that the New Zealand market was too small for these types of franchising, particularly when viewed in isolation from RealCo's Australian operations. For example, the Managing Director said:

*I don't think there is any advantages in New Zealand. I think it is too smaller country. But I see as we grow, and Australia becomes stronger, it may well be that people running both of those countries may want to acquire the rights to those countries, and just pay an ongoing fee for the name, the brand and, the development of the technology and the training (Managing Director).*

*We have thought about that (subfranchising). But while NZ is producing a profit in the way that we have, subfranchising at the end of the day is just going to reduce the revenue to the franchisor (General Manager).*

### **Market Growth**

Demand for real estate services is best described as turbulent, with the number of house sales frequently increasing or decreasing by 15 percent or more on the previous year. Long periods of negative growth were common and these had a marked affect on business operations. As noted by the franchisee and Managing Director, lean years highlighted inefficiencies as marginal offices find trading difficult:

*Last year it (demand) was down by about 30 percent, so that was a big drop... obviously the turnover was down, and our number of sales went down by about the same. So it just meant there wasn't the number of houses around - just not selling.*

*There was still a lot of stock on the market, so you are still marketing and promoting and doing the work, but there just wasn't the buyer... There were a number of companies who closed down and downsized and a lot of their people (sales consultants) came to us... People (sales consultants) started changing companies. They get a bit restless and think 'hey, I'm not making money' (Franchisee).*

*Yes it (negative growth) did [affect operations], because last year we discovered quite quickly that some of our offices were not capable of operating successful businesses, and we replaced and closed some of our franchises (Managing Director).*

These testing market conditions contributed to RealCo's resolution to limit and reduce future franchisee expansion, and consider ways of restructuring some existing multi-office networks. This was because, as stated earlier, the franchisor identified multi-office networks were more susceptible to performance difficulties than single-office operations. In an example, the General Manager noted how a declining market accentuated trading difficulties for one expanding franchisee:

*Yes one franchise and they have expanded into the area. But interestingly enough they bought another company which had 10% market share... which basically increased the offices by 50 percent. 12 months down the track the market has contracted, the offices are all shut, most of the sales consultants have gone - it was a disaster.*

### ***Customer Dispersion***

Demand for real estate services was highly dispersed. Such dispersion required RealCo to establish and support a large number of offices in geographically isolated locations. These requirements contributed to RealCo's franchising decisions. Specifically, RealCo were more likely to allow franchisee expansion in areas dispersed from the franchisor and regional support centres. This was because, as stated by the General Manager, isolated franchisees were more expensive to support:



*Where the areas are hard to service from our perspective, like the more remote it is from the regional office, the more likely we are to allow the aggregation. Like Kapiti, if you go up the Kapiti Coast. Well, you know, if Mic wants to put another office in he says 'well I want to do one in Foxton.' So well where's Foxton? [So we would say] 'yeah, that'd be great mate' ...but if it is a major metropolitan area then we'll look at it more harshly because we exert more influence in those areas where we have regional offices.*

Despite being more likely to endorse franchisee expansion in dispersed locations, however, multi-office expansion was, in fact, more prevalent in metropolitan areas. The General Manager said:

*The pattern is multi-office operators are generally only in major metropolitan areas... So generally outside the major metro (metropolitan areas), they are all single office operators.*

The Managing Director offered an explanation for this distribution. RealCo offices that are isolated from the franchisor, or support offices, are also often a long distance from other offices. The Managing Director felt large distances tempered franchisees desire and ability to expand:

*Any why would you contemplate having an office in Invercargill and Queenstown? It would take you half a day to get there! So there are some natural barriers which are created.*

### ***Competition***

Literally hundreds of competing firms were operating in the New Zealand real estate sector, including six with a nation-wide network of offices. The competition included two particularly strong companies from Australia (with more than 500 offices) that entered New Zealand recently, purchasing existing networks and expanding further to attain nation-wide coverage. The high and increased level of competition made trading difficult. Notably, price competition intensified contributing to decreased profitability and several

office closures within the industry. Illustrating these points, the General Manager stated:

*They (competitors) nibble away at the profitability of the business because you have always got someone who is discounting their fees dramatically to try and get business and they get a certain proportion of the business before they go broke, as they inevitably do, because you can't run a competitive business on a low fee strategy.*

Difficult trading conditions highlighted two issues. First, RealCo sought to improve office productivity and profitability in order to maintain viable offices. Second, as noted by the General Manager, RealCo sought to differentiate themselves from competitors by introducing new marketing initiatives:

*I think at the moment we treat the customers like they are all the same, [but] because of the competitive nature of the business now, you are having to find out more about the individuals needs and wants and positioning your marketing presentation around those.*

The franchisor's desire to improve office performance and differentiate contributed to the decision to limit multi-office franchisee size. As stated previously, the franchisor believed reducing franchisee size would help improve office performance and preserve bargaining power needed for implementing important new initiatives.

### ***Customer Diversity***

Demand for real estate services was quite diverse. Residential homebuyers (and sellers) had wide-ranging demographics (e.g., age and culture), circumstances (e.g., financial, existing property arrangements), tastes (e.g., desirable/undesirable property features) and expectations (e.g., sale price and possession dates). For example, when asked how clients vary most, the franchisee responded:

*Really in what they want and their time frames - and it is like going to buy a car - not everyone is exactly the same. Some people make a decision on the first day, some people take two months. So they are all over the place. Some people are more*

*realistic in what the value of their home is. Others have very high expectations and it takes a while for them to get used to the market.*

Two conflicting franchisor challenges were highlighted in this context of diversity. On one hand, sales consultants and offices needed to be responsive to different customer requirements. On another, both needed to be sufficiently similar in their responses to preserve brand equity. To balance both objectives, the franchisor developed all new initiatives centrally for use throughout RealCo.

Franchisor attempts to implement and monitor new initiatives in offices highlighted the need for franchisor control, and contributed to RealCo's franchising decisions. The franchisor's need for control contributed to two choices relating to franchising types. The first choice related to the franchisor's recent decision to limit and reduce multi-office franchisee expansion. As described earlier, experience had shown the franchisor that multi-office franchisees, which were more powerful due to large size, often impeded new initiatives designed for the benefit of all RealCo offices.

The second decision related to the rejection of area representation and subfranchising types of franchising. The General Manager thought that without direct control of offices, it would be more difficult to balance the conflicting challenges of adaptation and uniformity. In an example, he said:

*That area representative is a very interesting idea and it may well be that there are efficiencies. But at the moment we develop the training and the ideas centrally and what we have found is that if you have this situation here (area representation) you end up with three different types of training, three different systems, you know, in New Zealand. You would. And how you keep some standards - you end up with different marketing and it really starts to disseminate.*

Part of the franchisor's concern about area representation and subfranchising, which included a loss of franchisor control, related to the basis for area representative and subfranchisor remuneration. The General Manager felt that, because area representative or subfranchisor income is closely linked to franchisee revenue, such master franchisees

would more inclined to maximise revenue within their territories than support franchisor programmes intended for the benefit of all RealCo offices:

*[Because] this guy (area representative or subfranchisor) is on a revenue share they are less inclined to support national marketing and training and other initiatives because they try to maximise the profit out of it - and those sort of considerations go out the window, so you are fighting a battle all of the time.*

### ***Managerial Complexity***

Unit (or office) management tasks may not have been complex but they provided office managers with significant problems. Outwardly the tasks associated with office management appeared only moderately complex. RealCo offices offered only a narrow range of property services, by specialising in the sale of residential properties. Commercial sales and leasing, property management (including residential property management), real estate finance and insurance were all undertaken by separate entities. Offices also required few suppliers. The most challenging area for managers of offices was establishing and maintaining a dedicated team of sales consultants. On average, developing and operating a sales force involved recruiting, managing, co-ordinating and supporting 10 or more sales consultants. As stated by the franchisee, given the mobility of sales consultants, the difficulty of these tasks could not be underestimated:

*With our sales people, if they are working for us and they think that we are not doing a good job and they're getting ahead of us, and they are doing better business than us, you are going to say 'well look, there is no value in you guys, I'll go and work for someone else.'*

While franchisor informants felt the tasks associated with managing a real estate office were relatively simple, they noted many RealCo franchise owners and employee-managers had difficulties with their roles. Franchisor informants argued that one reason for such problems was a general low level of managerial skill within the Real Estate industry. In an example, the Managing Director, stated:

*The quality of the people in the industry is abhorrent... Most of the people who come into real estate come in via the mirror test - which is, you hold a mirror up to their mouth and if it fogs up you employ them because no one has looked at this business in a professional way.*

Franchisor informants felt that, given the level of managerial complexity, and perceived level of managerial skills (within the industry), training was of critical importance to RealCo's success within the real estate sector. The General Manager said:

*Well I think the franchise owners and the managers struggle with management, [so] we've put a huge emphasis on up-skilling our managers and our franchise owners in just the basics of management.*

Given the level of complexity, franchisor informants regarded training as central to success throughout RealCo, especially at the sales consultants and office manager level. Consequently, RealCo had a strong commitment to training for both groups. For example, consultants and office managers were comprehensively trained and tested before being allowed to operate. Furthermore, employee-managers of within multi-office networks were also required to pass an examination proving their recollection and understanding of RealCo's proprietary office systems, manuals and practices. RealCo also had a very strong commitment to ongoing training and development for both consultants and managers.

Both the General Manager and the Managing Director felt the level of managerial complexity influenced form choice in two ways. First, both franchisor informants preferred direct to indirect franchising forms. Both informants felt that, due the level of complexity, important franchisor-related functions, such as training, needed to be controlled centrally by the franchisor. Delegating franchisor-related functions, as would occur operating indirect forms, meant the franchisor would have less control over their delivery. The General Manager explained in relation to sales consultants:

*That's why the franchisor has a direct relationship with the sales consultants. Because we train the sales consultants through our new sales person induction course the franchisor has the first major contact to sow the seeds in the culture*

*with the sales consultants. And then we follow up in terms of the marketing the RealCo People, Home and Property, and other services. We deliver those direct to the sales consultants, so we can maintain a relationship with them. [With area representation or subfranchising] you would [lose control] because - we would expect these guys (area representatives or subfranchisors) to if they have got the same culture they will deliver it - but to a degree they would then be charged with running the new sales persons training course. So they (area representatives or subfranchisors) would have the relationship with the sales consultant and [the sales consultants would] become more remote to us... There will be loss of control.*

Interestingly, however, the General Manager conceded that indirect forms also had advantages. And while he preferred direct forms, given the level of complexity, other factors, including internationalisation, and a desire to reduce owner involvement, might ultimately contribute to RealCo adopting an indirect multi-unit form at some future date:

*However, one of the reasons we may move towards this model (area representation or subfranchising) is that it is the only way, at the end of the day, that the owners - that is 'the Managing Director,' myself, 'the Chief Financial Officer,' and 'another director' can get out of the day to day running. So with a private company like ours it is always hard to get out, unless somebody bigger comes along and says, you know, 'you're a juicy morsel, I want you' ... You know, in Christchurch we still get a call from a franchise owner having problems with a sales consultant [asking] 'Managing Director, 'General Manager can you help me out?' At the same time we are trying to get a merchant banker to finance the expansion into New South Wales to help us buy a large group over there!*

In the second area influencing form, the level of managerial complexity highlighted difficulties associated with managing multiple offices. As identified, managing one office can be problematic. And, as the Managing Director explained, in the following quotations, difficulties can compound with two or more offices:

*How easy is it for someone to run a real estate office? If they can read and write and follow instructions it really isn't hard at all. If you have got some*

*interpersonal effectiveness skills that will help a lot and if they have some focus and vision and a bit of excitement and some good communication skills, that's even better. That is one person [with] one office. The most difficult thing in the world is for that person to take those skills and superimpose them on another office that they are not running.*

*I had one office in Christchurch and I had one office for a number of years and it was a very successful office and I opened a second office twice and closed them down both times because it didn't work. It was only the third time I did it that it worked and I found out by the third time and all the pain that I had been through in the past why the first two hadn't worked and this was because I didn't have the right person in them and I didn't have a system and a structure for that second office to operate under which is where all of the training and education and stuff that we do now comes from.*

Consequently, he also said:

*Multi-office operations should only be available to people who have the capabilities to run those businesses. Now we did, because of circumstances, allow people who didn't have the capability to be a multi-office operator. Now we do terminate them, now. We do when we know there is a weak person.*

RealCo's decision to limit and reduce franchisee expansion was influenced by difficulties associated with managing multiple offices.

## **Summary**

Founded in 1888, RealCo had 145 real estate offices located throughout New Zealand. RealCo's form was characteristic of sequential franchising and area development. RealCo began franchising in 1990, after five years of intensive company-owned expansion that grew the chain from 14 to 100 offices. After embarking on franchising, the owners decided to convert all company-owned offices to franchises. Following this, the owners sought new franchise expansion to achieve more widespread penetration. The process of

conversion and new franchise expansion produced franchise arrangements characteristic of both sequential franchising and area development.

RealCo's form choices were influenced by numerous factors. I begin by summarising the influence of five factors, namely, incentives, access to capital, manager/franchisee ambition/retention, desire for growth and control. These factors influenced one or more of three notable periods within RealCo's franchise development, including the decision to franchise, the initial selection of franchising form, and recent amendments to form choice. Following this I summarise the influence of factors associated with environmental and task uncertainties.

Incentives strongly influenced two areas of RealCo's franchise development. First, incentives contributed to the initial decision to franchise. RealCo was realising poor returns from company-owned offices and pressure existed to improve performance. In response, RealCo owners felt franchising could enhance performance by providing office managers with better incentives to perform. In the second area, incentives influenced RealCo's recent decision to reduce and limit multi-unit franchisee size. On average, offices associated with multi-unit franchisees performed poorly in comparison to owner-operated offices. To improve office performance, RealCo's owners have decided to limit and reduce franchisee size and expansion, thus increasing the proportion of owner-involvement in offices.

RealCo's franchising decisions were also influenced by their access to financial capital. Franchising was selected initially, in part, because it provided expansion into small, isolated markets at lower cost, and therefore lower risk. The franchisor also realised further advantages. Franchising facilitated more widespread expansion by providing improved access to capital. Additionally, franchising lowered franchisor risk by removing and/or reducing franchisor investment in [previously] company-owned offices.

The ambitions of office managers and franchisees' also contributed to franchising choices. Prior to franchising, talented and ambitious employee office managers often left RealCo in search of greater challenges and opportunities. The decision to franchise, in part, reflected RealCo's desire to retain these managers. RealCo's owners felt that franchising provided



talented staff with an option to extend their personal and business objectives by becoming business owners. Franchisee ambition contributed to the high prevalence of multi-unit franchisees later in RealCo's development. Numerous franchisees sought to establish or acquire additional offices, and were prepared to leave the system if the franchisor resisted granting them.

RealCo's objectives for growth contributed to franchise development. RealCo sought very rapid growth to achieve their goal of establishing a nation-wide network of offices in minimum time. RealCo's desire for growth influenced the initial decision to franchise. Franchising was perceived to facilitate more rapid growth than company-owned expansion by providing superior access to both financial and managerial capital. RealCo's ambitions for growth also contributed to the extent of direct multi-unit franchising. RealCo's owners utilised sequential franchising and area development because they facilitated more rapid growth than single-unit franchising.

A desire for increased control also contributed to franchising choices. Later in RealCo's development, the franchisor decided to limit and reduce the size of multi-unit franchisees. Multi-office franchisees proved more powerful than single-office franchisees. Overtime, RealCo experienced problems related to increased franchisee power, such as difficulties implementing initiatives and monitoring. RealCo's desire to preserve control also contributed to the franchisor's preference for direct over indirect franchising forms. RealCo preferred direct forms because it allowed them to maintain greater control over individual real estate offices.

RealCo's franchising choices were also influenced, to a varying extent, by factors representing environmental and task uncertainties. The market size contributed moderately to RealCo's decisions and preferences. The franchisor preferred direct multi-unit franchising forms to single-unit franchising. Single unit franchising was regarded as too restrictive on unit growth, given the market's size. Market size also contributed to RealCo's preference for direct over indirect multi-unit franchising forms. Franchisor informants regarded the New Zealand market as too small for indirect multi-unit forms.

The market growth rate had only a minor and recent influence on franchising decisions.

Turbulent demand highlighted performance difficulties with multi-office networks, especially when compared to owner-operated offices. The performance differences, exacerbated in periods of market decline, helped contribute to the franchisor's recent decision to reduce and limit the size of multi-unit franchisees.

The level of customer dispersion within the Real Estate sector had a minor influence on RealCo's franchising decisions. Franchisor informants were more amenable to franchisee expansion in areas isolated from franchisor or regional offices. That was because establishing and supporting offices in geographically isolated markets was relatively more expensive. Multi-unit franchising was therefore preferred to single-unit franchising because it reduced the franchisor-related burden associated with establishing and supporting individual, owner-operated offices. Interestingly, however, multi-unit expansion was, in fact, more prevalent in metropolitan than isolated areas. Natural barriers, such as distance, helped explain the discrepancy, as geographic isolation made managing multiple offices more difficult. Consequently, franchisees in metropolitan areas were more likely to desire multiple offices.

Fierce competition contributed to RealCo's decision to limit and reduce the expansion of franchisees. Two franchisor-related challenges were highlighted in the context of intense rivalry, namely improving office productivity and RealCo's ability to implement new initiatives for the benefit of the system. Franchisor informants believed limiting franchisee expansion would help achieve both objectives by improving incentives for individual office-managers and preserving franchisor bargaining power.

Customer diversity had a modest influence on RealCo's franchising decisions. Demand for RealCo's services was quite diverse, highlighting the need to find a balance between adapting to local clients and providing a standardised service. For the franchisor, achieving the balance required maintaining bargaining power and direct control of individual offices. The need for balance contributed to two franchising decisions, namely the decision to reduce the size of multi-unit franchisee holdings and RealCo's preference for direct over indirect multi-unit franchising forms.

The final factor, managerial complexity, also influenced RealCo's choices and preferences

pertaining to franchising forms. While tasks associated with managing a real estate office were not considered complex, they provided managers with significant difficulties. These difficulties highlighted the importance of providing office managers and franchisees with quality training and development. Franchisor informants preferred direct to indirect multi-unit franchising forms, because they enabled them to ensure the nature and quality of training provided. The complexity of office management also highlighted difficulties associated with managing multiple offices. These difficulties contributed to the decision to limit and reduce multi-office franchisee size and expansion.

## **CHAPTER 5**

### **CASE DESCRIPTIONS: INDIRECT MULTI-UNIT FRANCHISING**

#### **Introduction**

This chapter presents case descriptions of three companies utilising the third, and final, category of franchising form, namely indirect multi-unit franchising. The three companies explored in this chapter include SnackCo, ServCo and FastCo.

## SNACKCO

### Description

Founded in 1991, SnackCo comprises a network of 36 operators that sell snacks and beverages in organisations throughout New Zealand. SnackCo also had 15 operators in Australia, controlled via a master franchise agreement with an independent company. This case focuses on New Zealand operations.

Snacks were presented in cardboard display boxes called snack trays. Each tray was stocked with 60 to 70 items, such as potato chips, biscuits and chocolate bars. SnackCo also offered beverages, including cold soft drinks and facilities for hot drinks. The SnackCo founder described the concept as an “in-house, self-service catering system.” All items cost a dollar and customers placed money in an honesty box. Snack trays and beverages were located in a myriad of sites (e.g., staff rooms, waiting rooms and production areas) in a variety of organisations (e.g., factories, doctors practices, law firms, schools and universities). A large proportion of SnackCo’s revenue derived from snack tray sales.

SnackCo operators developed their businesses by seeking additional sites for trays and beverage facilities. Established sites were then routinely monitored, which involved visiting sites to replace, replenish or remove trays and beverages. The frequency of site visits depended on individual site consumption and varied from daily to monthly. Operators established and managed numerous sites. The franchisee interviewed operated with his wife and had more than 300 different sites in the Canterbury region.

SnackCo utilised single-unit franchising, but was changing to area representation. The primary focus of this case is SnackCo’s decision to adopt area representation. Under the current single-unit franchising form, all SnackCo operators are owner-operating franchisees and work in exclusive territories. Franchisees are able to employ workers, and the largest has five employees. Many operate as husband-wife teams. The franchisor maintained a direct relationship with franchisees and centralised all franchisor-related activities, such as franchise recruitment and the provision of ongoing franchisee support.

The franchisor management team comprised six people. There was four permanent staff, including a General Manager, Administration Manager, Marketing Manger and Business Development Manager (BDM). The founder/director (35 hours/week) and a second director (5 hours/week) also assisted franchisor operations. The franchisor recruited, managed and monitored all franchisees directly. Notably, SnackCo's BDM travelled the country providing franchisees with direct and on-going support. The franchisor also arranged regional and nation-wide conferences for franchisees. Additionally, the franchisor met regularly with a Franchisee Advisory Council and Franchise Initiatives Committee, comprising democratically elected franchisees, to discuss and solve issues and explore new opportunities.

The area representation form proposed involved establishing five Regional Franchise Directors (RFDs), or area representatives, in exclusive areas throughout New Zealand. RFDs would provide franchisees with more intensive, and localised, support, than is currently provided by the Business Development Manager. The founder believed increased support would facilitate unit-sales growth and market penetration. RFDs would be contracted to the franchisor but not with franchisees: the franchisor would maintain a direct contractual relationship with franchisees. RFDs would also not operate as franchisees, nor would they be involved in franchise recruitment. Regarding recruitment, however, the founder believed the presence of RFDs would assist this activity by signalling SnackCo's commitment to supporting local franchisees. RFDs would pay the franchisor an initial fee. In return, RFDs would receive a percentage of sales from franchisees within their territory. Franchisees would also continue to pay the franchisor a royalty fee, however the percentage would decrease following the introduction of RFDs.

The new proposal contained two further changes affecting operating franchisees. First, the franchisor planned to remove franchisees rights to an exclusive territory. Instead, franchisees would retain exclusive rights over existing customers and gain freedom to compete for new sites within the larger RFDs territory. RFDs would be responsible for maintaining a database of franchisees and customers within their territory. In the second area, the franchisor planned to limit the number of employees franchisees can hire.

## Development

The founder started SnackCo in Hamilton, New Zealand in 1991. The founder moved to Auckland the following year and commenced franchising by selling the Hamilton area. At that point, the founder regarded franchising as a lucrative opportunity requiring little effort:

*Then it was “hey, we will sell you an area and we’ll make some dollars out of it,” and that was what we perceived to be the activity.*

Six territories covering the remainder of New Zealand were soon sold to separate franchisees. Subsequently, the founder realised the territories granted were excessive in size. Substantial parts of territories went undeveloped meaning more operators could be sustained and greater revenues were achievable. The founder encouraged franchisees to split and sell parts of their territories in an attempt to remedy this situation. Franchisees embraced the process to the extent there were 36 separate franchisees operating at the time of the investigation.

Despite increasing the number of franchisees, the founder remained unhappy with the level of market penetration. He believed territories were still large, and added that many operators were not realising the opportunity he perceived to exist. For example, he noted certain franchisees appeared content with their current level of performance and were failing to approach certain organisations and/or entire areas within their territories. Further, some franchisees were not marketing SnackCo’s complete product line to organisations, preferring instead to focus on snack trays. Concerning the latter, the founder said:

*From an implementation angle, what happens is because snack boxes are very easy at one extreme and hot drinks are more difficult at the other extreme - because one involves some sales skills and the other one doesn’t under the present system - you have selective implementation. Selective implementation is the franchisee can choose to do something and say “well I’ll do this... I don’t know*

*about carrying all those cans of Coke around, they are bloody heavy and, you know, well the money is not as good so therefore hey, I will do the snack boxes but you know I won't worry about doing those other things." So then as franchisor you miss out on that opportunity completely.*

Founder discontentment with the current level of penetration led SnackCo to develop, and attempt to implement, an alternative type of franchising. The founder believed that changing the type of franchising, and configuration of territories, would increase market penetration and lead to greater system-wide performance. SnackCo was in a transitory phase at the time of the investigation. While the new form had been conceptualised, presented to franchisees and advertised, it was not implemented.

Interestingly, the proposed form and territory changes met considerable franchisee opposition, which provided an impediment to the implementation of the overall initiative. The franchisee interviewed struggled to understand how the new configuration would benefit his business. From a franchisees perspective, he could see only disadvantages. In particular, he felt threatened by the proposal to remove the exclusive rights for operating within his territory. Removing these rights, he reasoned, would increase uncertainty and [likely] reduce his and other franchisees personal market size.

### ***Franchise Imperatives***

SnackCo form choice was influenced by a number of factors. We begin by outlining the influence of three factors, namely incentives, access to capital and a need for control. Incentives strongly influenced three areas of SnackCo's franchise development. First, incentives influenced the initial selection of single-unit franchising over direct multi-unit franchising forms. Guiding this, and subsequent decisions, the founder strongly felt that employees did not perform as well as owners:

*They (employees) under-perform, they under-achieve; they cost you a lot of time, energy and effort... You know, as long as I have been around in franchising, I have not seen one employee-based store or business outperform an owner-operator.*

Consequently, single-unit franchising was preferred to direct multi-unit franchising forms



because it preserved a higher proportion of owner to employee-operators.

Second, incentives influenced the decision to adopt area representation. The founder preferred area representation to employing additional support staff because it provided RFDs with enhanced incentives:

*We have a lot of opportunity - so we can see opportunities out there - and our goal is to say well how can we soak up some of those opportunities, and one of the ways of doing that without adding more employed staff and more overhead is say "well lets base it on performance within the market," and hence the concept of a Regional Franchise Director.*

Third, and finally, incentives contributed to SnackCo's decision to increase the proportion of owner-involvement in current operations. The founder reasoned that this would increase performance:

*Our move is away from that (a form where franchisees can hire employees) to strictly owner-operator. We have identified that owner-operators provide a much higher level of performance than you know if they are employees it just doesn't work in our business - which is all cash. Almost without exception employees steal cash; [the] temptation is just too great. So from a performance angle we need to move to owner-operators.*

The second factor, access to capital, also influenced the decision to adopt area representation. As indicated in an above quotation, the founder regarded the alternative to RFDs, which involved instituting additional salaried regional managers, as expensive to the franchisor.

The third factor, a concern for control, contributed to SnackCo's selection of area representation over subfranchising. The founder wanted to maintain direct control over operating franchisees. While area representation involved delegating certain functions, such as co-ordination and support, the franchisor continued to maintain direct control of franchisees. By contrast, the founder felt subfranchising, which involved more complete

delegation of franchisor-related tasks, such as franchise recruitment, management and support, reduced franchisor control of franchisee operators to an unacceptable level. In an example, the founder said:

*I just feel that master franchising (subfranchising) is fraught with danger... In a master franchise situation usually the subfranchisees are contracted to the master, not to the franchisor. So I just feel that situation, based on my experience is, if you have got an under performing master, you have got an extremely difficult exit program if things go wrong, and therefore whoever fulfills that role (providing local support to franchisees), needs to be warehoused to one side, [so] they can be cut off over night.*

## **The Environment**

### ***Market Size***

The size of SnackCo's market highlighted the costs involved in providing franchisees with adequate assistance. SnackCo had 36 franchisees and the founder believed the market could sustain both much higher sales per franchisee and at least five further franchisees. The founder wanted to attain full market penetration but realised achieving that goal would require furnishing franchisees with increased levels of ongoing support. The founder felt one travelling support person was insufficient, given the size of the market, and said that five dedicated personnel were really needed. Furthermore, he said support personnel should be located close to franchisees.

SnackCo's choice of area representation was influenced by the costs associated with providing franchisees with the needed level of support. The founder preferred area representation to single-unit franchising because it provided franchisees with greater support at low cost. As the founder said in an earlier quotation, area representation obviated the franchisor's need to hire additional staff and increase overheads.

The founder also favoured area representation to subfranchising given the context of demand size. Specifically, he felt that the New Zealand market was too small for subfranchising to be viable. He noted that while many franchise systems had used

subfranchising to facilitate growth, subfranchising reduced the level of franchisor income over the long-term:

*I believe that for a lot of people to grow they have needed the funding of master franchises – that has been the overriding factor. The trade-off of that is that they have dissipated the revenue steam that they could have got.*

### **Market Growth**

The market for SnackCo's product line was growing. Estimates by the founder and franchisee ranged from 15 to 20 percent growth per annum. In this context, the founder wanted to grow SnackCo sales at a rate at least commensurate with demand growth. Otherwise, he noted:

*What happens is what has happened, is that competitors can come into the market as well... You have got to capture it today, because tomorrow if we don't take it someone else is going to take it.*

The desire to grow sales contributed to the decision to increase franchisee support. The founder believed sales could be increased dramatically by working more closely with franchisees to identify and attain new customers, and build sales within existing sites.

The founder preferred area representation to hiring additional franchisor support staff for two reasons. First, area representation was more cost effective because area representatives were responsible for creating their own income. Second, as identified previously, the founder felt area representatives were better motivated than franchisor employees to assist franchisees, because their remuneration is tied to the performance of the franchisees they support.

The founder further illustrated the important influence of demand growth on form choice. The founder thought the advantages of area representation compared to single-unit franchising were greatest in a growing market. By contrast, in a period of zero or negative growth, he said single-unit franchising, which involved employee regional managers may, in fact, be more optimal:

*Ours (the proposed area representation form) is very much geared around a growing system as opposed to a maintaining system. So if I was SportCo, it would probably be very difficult to have that system (area representation) because you are semi-mature. Whereas we are very much immature, and therefore I think it has more effect when you are a growing business, and I think there is a bit of built-in obsolescence ... you can grow them into a corporate structure at some point.*

### ***Customer Dispersion***

SnackCo's customers, and potential customers, are spread throughout New Zealand's cities and towns. Reflecting that dispersion, SnackCo has 36 franchisees operating in different parts of the country. Dispersed demand, and therefore dispersed franchisees, highlighted the costs associated with assisting and supporting geographically isolated franchisees. As the founder stated, there were substantial costs associated with visiting dispersed franchisees:

*Travel to the South Island is very expensive, or vice versa, to bring people from the South Island to the North Island is very expensive, and [especially] given you have less business in the south than the north.*

The founder considered the cost of support to be of particular importance given SnackCo's goal to improve market penetration, and his understanding that achieving that objective would require increased, and more localised, franchisee support. He also realised that support could not be provided from a centralised location. Instead, personnel needed locating close to franchisees in order to sufficiently understand their markets and provide more thorough and timely support.

The founder's consideration of costs involved with increasing franchisee support influenced the choice of franchising type. Two options were seriously evaluated. The first involved continuing with the current single-unit franchising form, but adding a network of regional managers paid for by the franchisor. The second included instituting a network of area representatives (or RFDs). The founder preferred area representation because it meant

the franchisor did not have to directly hire extra support staff. In addition, he felt that area representatives would be more motivated to provide franchisees with quality assistance, due to the structure of remuneration, and that this would produce greater market penetration:

*The concept of a regional franchise director has a certain area of responsibilities, including the development of new opportunity and also the soaking up of existing opportunity. If you live in the market you have a much better grasp of it. Well, you are 'Johnny on the Spot,' and therefore you are going to be 'Johnny on the Spot' moving faster, and the rewards you get then (as a RFD) are based on what is actually achieved in the market place, which should be much greater.*

Area representation provided one further, but indirect, advantage in the area of franchise recruitment. The founder thought that while the area representative would not be directly involved in attracting or selecting franchisees, their presence would assist franchise sales in dispersed locations:

*When you (the franchisor) are in Auckland and you want to sell a franchise in Canterbury - they (prospective franchisees) immediately see themselves as being a zillion miles away and sort of mentally disconnect from it in the beginning. So that's the weakness. The strength of franchising (having RFDs) is the fact you can get someone there and they are 'Johnny on the spot' and they are perceived to be local, and that is the strength (Founder).*

### **Competition**

With around six direct competitors, none with nationwide coverage, neither the founder nor franchisee regarded the level of competition as particularly intense:

*In terms of strong competitors, [we] probably only have a couple, and they are showing signs of perhaps cracking slightly. I believe what will happen is that in another couple of years there will probably be a dominant player in the market, and there will be some sort of fragmented, bit players who could be very regional - so it might be someone in Invercargill doing some fund raising activity for a*

*particular cause, perhaps. So in terms of another national competitor, I have a feeling there may be none at all, but that said, we still have plenty of competitors out there. I mean our competitors are dairies, gas stations, super markets - I mean they are our real competitors; other people doing what we are doing I would suggest are actually less of a competitor (Founder).*

*[There are] five different operators in Christchurch. There is competition, [but] we feel that we operate better than anybody else so we don't see it as a great problem. In saying that, like any business, if you didn't have competition it would be better, but we don't really seem to see it as a big problem... I would say that we would have most of the market. We would be the biggest operator in Christchurch (Franchisee).*

Despite having only moderate levels of competition, SnackCo's founder was concerned about new competitor entry and growth. The founder felt that, as illustrated in an earlier quotation, considerable unrealised market potential existed and, if SnackCo did not seize it, their competitors would. This situation contributed to the proposed utilisation of area representation. The founder realised that, in order to win market share, franchisees required increased assistance. In this context, the founder preferred area representatives to hiring additional franchisor staff because area representation provided local and motivated franchisee support at lower cost.

### ***Customer Diversity***

SnackCo customers exhibited surprisingly similar wants and preferences, considering both variety in site places (e.g., from factory floors to lawyers' offices) and locations (e.g., Invercargill to Auckland). Location and climate changes provided some differences. However, the founder and franchisee were agreed such differences were minor, and easily managed:

*The majority [of customers] are very similar actually, being in business or a work place, I'd say they are predominantly similar... You'll get isolated pockets of preference for a particular product, because it could be locally made. So you will*

*get somebody in Invercargill [who] wants a short bread log because that is something that is made in Invercargill by a well known supplier, so that would be a local preference... It is very easy to accommodate (Founder).*

*The first thing you do before you touch anything [is] you read the tray, and it only takes 5 or 10 seconds. You have a look [and] if there is no biscuits there you make a note. We have cards that [show the] date, number of products returned, cash and the difference... If we went in there and saw all of the biscuits were gone we would make a note in this column: 'Biscuits.' It is all we need to put, and we know that there is extra biscuits required... It only takes 5 or 10 seconds, you know, like earlier on it used to take us a bit longer, but it is like anything. But now we can read a tray, make a note and then alter things to suit. In saying that, it is a seasonal thing. The reason I am saying biscuits all the time now is because biscuits are the big thing that are going. So it is pretty uniform right through the whole system, that all the biscuits [at] this time will get increased (Franchisee).*

The founder's decision to adopt area representation was not influenced by the level of customer diversity. When asked, the founder said:

*No, because it is strictly a marketing implementation effort. So there is absolutely zero impact on the types of franchising.*

### ***Managerial Complexity***

While physically demanding, SnackCo franchises were relatively simple operations to manage. The product line contained fewer than 80 products. These were obtained from five suppliers, one of which was the franchisor. The process of preparing and monitoring snack trays was easy and because franchisees hire few or no employees, the complexities associated with staff management were low to non-existent. Most aspects of operating, such as, canvassing customers, monitoring trays, dealing with suppliers and preparing accounts, were repetitive, varying little from day to day and week to week. Consequently, as stated by the founder and franchisee, the businesses were simple to manage and new franchisees built confidence rapidly:

*In our business, by the time people have been operating for a month, given the business is fairly repetitive, they actually know what they are doing pretty well (Founder).*

*It is not difficult at all. As I say, with experience, it becomes quite easy (Franchisee).*

The founder compared SnackCo to other types of businesses, and highlighted the relative simplicity of SnackCo operations:

*[It is] relatively simple. That is one of the beauties of it. [It is a] fairly straightforward business. [It is a] good entry-level business for first time business owners, you know, it has the advantages of no debtors, so there is no credit management control. All they have got to do is process invoices on one side and stock on the other and follow the system. So I would say [it is] relatively straightforward compared to running Mail Boxes Etc, for instance, which is much more complicated, or a sports retailer, which is a more complicated activity again.*

The founder considered the managerial complexity of SnackCo operations and said that it did not influence his choice of franchising type:

*Does it affect the system we use? Not really, it is not part of the decision making process.*

However, he did note that while he felt that area representation was appropriate for SnackCo, it would not suit a franchise system operating a more complex retail concept:

*Ours is relatively straightforward. Does that in anyway affect the type of franchising? Possibly it does. Again, I think that we could overlay the system we are going to use really over virtually any system at all, except possibly a retail one. I think it would probably fall down.*



## Summary

SnackCo was in the midst of a franchisor driven transition from single-unit franchising to area representation. From founding in 1991, SnackCo adopted single-unit franchising and allowed franchisees to hire multiple employees. Six large unwieldy and exclusive territories were initially granted to franchisees covering the whole of New Zealand. Such large areas coupled with the performance of that form-territory configuration left large portions substantially underdeveloped. The founder subsequently coaxed franchisees into splitting and selling parts of their territories to the extent there were 36 franchisees at the time of the investigation. Yet despite positive changes, the founder remained dissatisfied with system-wide performance; significant opportunity remained unrealised. The founder's feeling of discontent provided the catalyst to increase the level of franchisee assistance and, select area representation to replace single-unit franchising.

The founder's decision to adopt area representation was influenced by a number of factors. After deciding that increased franchisee support was needed, the founder evaluated how this could be provided. He considered two options. The first involved establishing a network of area representatives while the second involved adding a network of regional managers paid for by the franchisor. The founder's choice of area representation was strongly influenced by incentives. The founder wanted to provide operators and support staff with incentives that motivated them to perform to the best of their ability. Based on his experience, the founder preferred area representation because he felt area representatives would be more motivated than employee-regional managers (hired by the franchisor) to provide franchisees with quality assistance. Consideration of incentives also influenced other aspects of SnackCo's franchise development, including the initial decision to adopt single-unit franchising over sequential franchising and area development. Incentives also influenced the decision to limit the number of employees franchisees can hire.

SnackCo's choice of area representation was also influenced by access to capital. The founder preferred area representation because it obviated the costs associated with the franchisor hiring employee-based regional managers. The adoption of area representation was also influenced by a need for control. SnackCo's founder preferred area representation to subfranchising. Comparatively, he felt that subfranchising reduced the franchisor's

control over operating franchisees to an unacceptable level.

SnackCo's adoption of area representation was also influenced by environmental and task uncertainties. The market size, rate of market growth and the dispersion of customers all influenced SnackCo's decision to adopt area representation. The founder felt that, given the market size and rate of growth, considerable potential existed to build sales and increase market penetration. However, realising this opportunity required increasing the level of franchisor-related assistance provided to franchisees. Furthermore, due to the level of customer and franchisee dispersion, this support was needed in a wide range of isolated markets. This context of demand size, growth and dispersion contributed to the selection of area representation by providing increased, and localised, assistance to franchisees at minimal cost to the franchisor. Furthermore, the founder preferred area representation because he felt it provided localised support staff that were not only cheaper but also more motivated, due to the structure of their remuneration.

Other factors, namely competition, customer diversity and managerial complexity, had a more minor to nil affect on SnackCo's choice to adopt area representation. Of these three factors, competition influenced SnackCo's decision most. While facing only moderate levels of competition, the founder was motivated by the threat of competition to increase sales growth. He felt unrealised market potential existed and that SnackCo needed to seize it before competitors. The founder preferred area representation to other forms, in this context, because he felt it facilitated more rapid sales growth.

Customer diversity and managerial complexity had a minimal to nil affect on SnackCo's decision to adopt area representation. Customers were uniform in their wants and needs and SnackCo units were simple to manage. Consequently, the founder said neither factor influenced his decision to adopt area representation.

## SERVCO

### Description

Founded in 1989, ServCo is a household and commercial services company with 550 owner-operating franchisees. ServCo provided lawn mowing and gardening, pet care, home cleaning, home security, car valeting, carpet cleaning and pest control, ironing, pool valeting and commercial cleaning services throughout New Zealand.

The company utilised subfranchising and was configured as follows. Subfranchisees purchased the right to own and operate one of eight services. Subfranchisees were not granted an exclusive territory. Instead, they operated alongside other ServCo subfranchisees in a larger territory controlled by a subfranchisor. Subfranchisees paid the subfranchisor a fixed weekly fee for an established client base, and had the option of selling new clients to the subfranchisor. Subfranchisees were limited to one franchise and could hire only one employee. Many had spouses who assisted them.

Subfranchisors purchased rights from the franchisor to develop one ServCo service within a specific territory. Subfranchisors recruited subfranchisees to operate within their area. While the franchisor was party to the agreement between the subfranchisor and subfranchisee, it delegated full responsibility for subfranchisee selection to the subfranchisor. The franchisor, however, often assisted new subfranchisors to recruit initial subfranchisees. Once recruited, the subfranchisor trained and supported new subfranchisees on an ongoing basis, to the extent subfranchisees had little need to contact the franchisor directly. The actual type and extent of ongoing support provided by the subfranchisor to the subfranchisee was dependent on the particular service. However, support normally included managing a call centre, client database, quoting, distributing new work, local advertising and, the presentation of training and education. Subfranchisors also monitored the performance of subfranchisees, in such areas as workmanship, conduct and presentation. Subfranchisors could simultaneously operate as subfranchisees and indeed many did, by necessity, to supplement income and expedite franchise recruitment (by developing then selling a client-base to new franchisees). However, subfranchisors were limited to one subfranchisor arrangement.

The franchisor focused on growing and managing the ServCo system. The franchisor recruited, trained and supported subfranchisors. Support activities included regular contact and coaching of subfranchisors, sharing information, arranging group discounts (e.g., for fuel, equipment, communications, insurance and clothing) and regular site visits. The franchisor also arranged regular meetings with an advisory group comprising democratically elected subfranchisors and organised annual regional conferences for all subfranchisors and subfranchisees to attend. The franchisor comprised a small team that included the founder/managing director, a general manager, executive assistant and part-time accountant.

### **Development**

In 1989, the young founder began mowing lawns and gardening in the Auckland area. He had little idea of the sector's potential at this stage. However, an expanding client base gave him food for thought and, after 18 months of operating alone, he attempted to grow the business by hiring employees. But this created problems:

*I did employ people briefly, but on a small scale. I just didn't like it. I hate people not turning up, and the quality not there. You had to be there to guide them all the time (Founder).*

He then attempted expansion a second time by developing and marketing a business and franchise format to owner-operating franchisees. The founder noted the improvement:

*People investing into a business and they put 100% effort into it. Employees do, but someone who invests money will always try a lot harder.*

To begin with, the founder visualised a small network of franchisees in his local area. However, demand for ServCo franchises and services was unexpectedly high:

*The first ad we put in the paper we got about 50 calls and we pre-sold four... When I first started I thought I would just keep to Auckland and around 20 operators, but it just grew so fast, it just kept multiplying.*

After just one year franchising, ServCo comprised 15 franchisees. The founder then realised the potential for a much larger organisation with scope beyond Auckland. Subsequently, he revised his goals and aspirations and set about building ServCo into a nation-wide company.

The founder selected subfranchising to replace single-unit franchising after a short period. Considering his newly revised growth objectives, the founder realised practical limitations associated with single-unit franchising. In particular, centralising all franchisor-related activities (including quoting, distributing work, local advertising etc.), while attempting to grow, was impractical:

*So I could see that I couldn't look after the ball from the start, so we broke off an arm, and sold that as a master. Then we used that system over the rest of the country as well.*

Subfranchising was then adopted throughout New Zealand. Initial development focused on lawn mowing and gardening services. Over time, further (and separate) services were added and expanded to the extent that ServCo comprised 550 subfranchisees controlled by 45 subfranchisors at the time of the investigation.

### ***Franchise Imperatives***

ServCo's organisational form was influenced by a number of factors. The franchisor's desire for growth strongly contributed to ServCo's adoption of subfranchising. ServCo's founder was ambitious and sought very rapid growth. That ambition was evidenced in the decision to build a nation-wide network of franchises for not only lawn mowing and gardening, but also seven additional services. Furthermore, at the time of the investigation, ServCo was actively exploring, developing and refining new service ideas, as well as considering overseas expansion.

The decision to adopt subfranchising largely reflected the franchisor's desire to grow ServCo more rapidly:

*The move was made to obviously grow the business a lot quicker and by having the master franchisees you had another level or person to liaise [and] keep the business growing as well. So really it came down to growing it, and that is one of the reasons why we are nationwide, because we have got that person in that area actually pushing it hard and creating the system in that territory (Founder).*

By subfranchising, ServCo acquired important financial and managerial resources from subfranchisors that helped to expand the system. Importantly also, subfranchising provided area managers (subfranchisors) and operators (subfranchisees) that were highly motivated due to the investment they had made in their respective businesses. Indeed, the concept of incentives contributed strongly to ServCo's organisational form choice.

ServCo realised the motivational power of ownership based on experiences with employees and initial franchisees. Those experiences helped strengthen a belief that people operate more diligently, and therefore seek greater growth, when they own their own business. Subfranchising was seen as optimal organisational form that could provide good incentives:

*We say it is best to have the subfranchisee owner-operator person who takes a vested interest in their business, particularly with services like cleaning where you have got somebody going into the home. You just don't have that same level of responsibility and sort of ownership involved when you have got an employee doing it. I would suggest that that area developer franchise person would have problems with, you know, hiring and firing and staff turnover, and a whole host of other issues that you don't get with a subfranchise system (General Manager).*

*Any one that invests has got commitment because he is the one that has borrowed the money. So they are going to try in it, they are going to look after the customers [and] they are going to pamper the customer... I know for instance with 'Company X' (home cleaning franchise company) they employ lots of people and you just lose*

*control of who is out there doing it. Are they (the employees) wearing uniforms? Are they turning up? (Founder).*

## **The Environment**

### **Market Size**

The market size for ServCo's service range was very large, meaning scope existed for literally hundreds of ServCo operators. That level of potential highlighted the financial cost and managerial burden that would be associated with growing and managing a large network of operators. As stated by the General Manager, ServCo understood that such a large size would not only require numerous operators, but a network of regional managers as well:

*With the size of ServCo there is no way we could effectively manage all of those guys out there. I mean you have to, I think, have regional managers in place to deal with it. I just don't think you'd be able to maintain any consistent growth either. I think that is one of the advantages [of subfranchising] is that the subfranchisee is directly contracted to the subfranchisor (General Manager).*

Given the level of demand subfranchising was preferred for its capacity to manage a large network with minimal franchisor investment and involvement. Importantly, the franchisor considered the scale of demand too large for all alternative types of franchising, including area representation, subfranchising's closest variant. For ServCo, subfranchising was advantageous because it enabled the franchisor to cost effectively, and more completely, delegate tasks of regional management (including operator recruitment, training and support) and operation (e.g., mowing lawns, ironing etc.) to subfranchisors and subfranchisees, respectively. Area representation, in contrast, which would involve less complete delegation, including maintaining centralised recruitment, would be intractable. The founder and general manager stated:

*I mean we would find that (area representation) hard because when you have set up right throughout the country, I mean you are having to vet every person... we would have up to 30-40 inquiries a day, just on a daily basis, so it would just be*

*mind boggling... I am actually (currently) doing the [franchise] sales for our commercial cleaner, and that alone just ties you up (Founder).*

*I think that (area representation) would be a more cumbersome system, just in terms of the communication. Because these guys are contracted directly to the franchisor, I think there would be some issues in terms of size (General Manager).*

### **Market Growth**

Growth in demand for ServCo's services was rapid. Illustrating that growth, the General Manager stated:

*I mean all of our services, I think it is just a huge market untapped, you know, there is no slowing up in the amount of work coming in.*

Both franchisor informants felt that lifestyle changes were fuelling a trend toward outsourcing activities historically performed by the householder. Further, they add that this trend not only provides growth for their existing service range, it also provides scope for additional services. Both currently estimate average industry growth (for their service range) to be 20 to 30 percent per annum, although certain services, such as ironing, at around 50 percent, were growing faster. In view of this, ServCo continued to expand their network, of subfranchisors and owner-operating subfranchisees, as fast as possible. As stated previously, by the founder, subfranchising was preferred over alternative organisational forms for its unrivalled capacity to facilitate rapid growth with minimal resources. Both the founder and General Manager added:

*The first year we got around 14 to 15 operators – which was quite good in those days, as around one a month – that was quite staggering. We thought it was bloody wonderful. But from that point onwards, we have got these territory owners putting all their effort into their areas. So then it started just moving really quickly (Founder).*



*I mean it is still just such a growing market. It is. I mean there is going to be a level I think any company gets to and it becomes hard but, you know, we are lucky, once again, because we have got that master. So really, they are actually growing it for you (General Manager).*

### ***Customer Dispersion***

ServCo's customers were highly dispersed. Given the potential scale of operations costs, associated with establishing and managing hundreds of geographically isolated operators to service these customers, were immense. Furthermore, due to geographic isolation, tasks such as, franchise recruitment, training and support were not only expensive, but also problematic to provide from a centralised location. A desire to minimise the costs contributed to form choice. Subfranchising enabled the franchisor to minimise costs by delegating tasks to subfranchisors. As noted by the founder, the utility of subfranchising increased with dispersion. Conversely, the utility of subfranchising would have been less if ServCo were more geographically concentrated: The founder illustrated these relationships:

*If you weren't going to be in Wellington or Christchurch - I mean you need that master level to do what we have done - so you could change your set up... [Then] by just having all your services in Auckland, and having a different structure - I mean I think more than likely there would be more money in actually employing people...you would just do it all from here... [and] you might have someone that would look after the lawn mowing branch you'd have someone to look after the home cleaning branch (Founder).*

### ***Competition***

Rivalry in the domestic services sector was intense. ServCo had numerous and varied competitors, ranging from other large multi-service franchise operations with nation-wide networks through to beneficiaries odd-jobbing for cash. While the extent of rivalry varied for each ServCo service, informants, as illustrated by the General Manager, clearly regarded the overarching domestic services sector as highly competitive:

*The competition is rife out there. I mean it is ridiculous. It is a bloody tough market to be in... carpet cleaning is probably the most competitive... you just need to open up the yellow pages... In Auckland, I would have thought that there would be 50 companies doing that. Sure a few of them are 'one man bands' ... I'd say we are probably the third biggest in Auckland. I mean all of the services have a hell of a lot of competition, whether it is franchised or not (General Manager).*

Interestingly, a factor contributing to the level of competitive intensity was the low costs of entry. As stated by the General Manager, low establishment costs meant their concepts were attractive for competition:

*One of the reasons that there is such a huge amount of competition is that it is relatively easy to get into the market - there are low set-up costs. I mean if you want to be a lawn mower all you need to do is go and buy a mower and wack it in the back of your car. I mean the number of people that I think are unemployed and you know going out part-time and doing these services for cash, you know it is phenomenal.*

Competition from franchised and non-franchised sources influenced ServCo's form choice by highlighting one key management challenge. ServCo demanded a form that would allow them to penetrate the market more rapidly than competitors. Illustrating this, the founder stated:

*The idea is once you start up a service is that you have to go like hell, otherwise you just get left behind.*

Subfranchising was preferred in this context, as stated by the founder, for its unrivalled capacity to facilitate very rapid growth:

*Just put people (subfranchisors) in these areas and they grow it for you. So it is no good just doing it by yourself - setting one up then moving [on to the next] - you'd just be left behind. You've got to get in there and sort it out and go for it.*

*Obviously in the main centers we are looking to take on masters all the time. We want to get it out there before someone else does.*

### ***Customer Diversity and Managerial Complexity***

Demand for ServCo services was homogeneous. ServCo customers had very similar needs and wants. That similarity was due, largely, of course, to the very specific needs ServCo services are designed to satisfy. All informants were agreed that while possessing a variety of backgrounds, customers shared the same basic need:

*I mean you get different people that are using the different services... but everyone is the same, I mean all they are really wanting is someone to come there regularly and to do the job (Founder).*

The tasks associated with operating ServCo's range of service concepts, while physically demanding, were simple and uncomplicated. As the founder stated in the following quotation, the concepts are simple to operate:

*It is such a simple system – there is nothing complex about it. That is why a lot of people like it. That is [also] why the lawyers and the bloody banks like it... Imagine owning a sports store and selling fishing gear, and you have to buy hooks and sinkers, and there are different types of fish in different areas - it would be a nightmare (Founder).*

That simplicity was illustrated in a number of areas. First, as indicated, the service concepts were narrowly defined. Each was defined to meet a very specific need such as, lawn mowing and gardening, ironing and carpet cleaning. Second, operators required few inputs to perform their services and therefore needed few suppliers. Third, operating franchisees were limited to hiring one employee. Fourth, the tasks associated with performing the actual services, were also simple. Indicative of this simplicity, as stated by the General Manager, the services can be, and are, highly formalised:

*It is a pretty simple system. What it comes down to is training at the end of the day, and the ongoing support... you know, a franchise system is that, it is a system, there is a way that we do things, it is documented in a manual. I mean occasionally we come across people who think they have got a better way of doing it. Now you know well if they have, well we encourage them to give us that feed back.*

The homogeneity of demand and simple tasks associated with operating provided few challenges for franchise system management. Importantly, compared to an environment with more heterogeneous demand and greater complexity, this context meant that the tasks of franchise recruitment, training, management and monitoring of operators was relatively simple. It also, according to the founder, meant such tasks were amenable for delegating to subfranchisors:

*If you got someone (subfranchisor) good there why can't he choose the right person, and if you have got a system going, then when you are choosing someone that person there should be able to do it. I mean you know it is his business, he bought it [so] he is going to work hard at it. You know, if you have got a good system then it is not going to be a problem (Founder).*

In contrast the founder noted that while subfranchising works for ServCo, it would be less appropriate in a more complex environment, such as that experienced by SportCo, the sporting goods retailer:

*Obviously in some of those (forms, such as area representation and subfranchising) it would be a lot harder (for a retail company to utilise). I mean we have kept it simple so their position is not complicated and everything. I mean retail you have got to buy the right products, you have got to have the right staff... it would be a nightmare. They don't even hold stock or anything in our case. I mean we (the franchisor) actually buy the stock like uniforms and allocate it out.*

## Summary

Founded in 1989, ServCo had a network of 45 subfranchisors and more than 550 subfranchisees providing one of nine home-related services to households and businesses throughout New Zealand. ServCo's organisational form was characteristic of subfranchising.

ServCo's adoption of subfranchising was influenced by a number of factors. Of these, a desire for growth contributed strongly. ServCo's founder was ambitious and sought very rapid growth. His desire to grow services quickly highlighted the important need for two further factors, namely access to capital and incentives. The founder preferred subfranchising to alternative organisational forms for its unrivalled capacity to overcome financial and managerial limits to growth, and incentives problems, at both the operating and regional manager levels.

Market and task-related factors also contributed to ServCo's use of subfranchising. Of these factors, market size and market growth contributed strongly to ServCo's choice. The scale of demand size and growth highlighted the level of financial investment and managerial burden associated with growing and managing a large network of operators. In that context, subfranchising was preferred for its capacity to facilitate and manage growth while requiring minimal franchisor investment and involvement.

The dispersion of customers and subfranchisee-operators also contributed to ServCo's choice of organisational form. The isolation of subfranchisee-operators highlighted costs and difficulties associated with the tasks of franchisor management, including the recruitment and on-going management of operating subfranchisees. Subfranchising was preferred for its capacity achieve both tasks at low cost. Comparatively, the founder noted that if operators were more geographically concentrated, a direct form could be preferred. ServCo's choice of franchising type was also influenced by competition. Competitive activity contributed to ServCo's desire to grow more rapidly than competitors. ServCo preferred subfranchising because it facilitated more rapid growth than alternative forms.

Finally, the level of customer diversity and managerial complexity exhibited little notable

influence on form choice. Homogeneous demand and simple tasks associated with operating provide few challenges for ServCo's operating franchisees, subfranchisors and the franchisor. In turn, this meant tasks associated with franchise system management, such as franchise recruitment, training and support, were amenable for delegation to master franchisees.

## **FASTCO**

### **Background**

Founded in 1983 in New Zealand, FastCo is a courier company with over 350 couriers in New Zealand and 500 in Australia. This case focuses on FastCo's courier operations in New Zealand, which comprises more than 350 franchisees. It excludes consideration of FastCo's overseas operations, as well as their postal network, launched (and franchised) in 1998.

FastCo specialised in document and parcel delivery. 350 couriers operated vans making collections and deliveries. Each courier developed and managed a customer-base within an exclusive geographic territory. Operating as a courier involved the pick-up and delivery of documents and parcels within their area. Items with destinations beyond that area were taken to the local FastCo depot where they were sorted either for 1) delivery by other FastCo couriers affiliated with that depot, or 2), line-haul delivery to one of 21 other FastCo depots located throughout the country. At the depots, individual couriers collected items originating externally, for delivery within their specific operating area.

FastCo operated the subfranchising organisational form. There were three levels of franchisees: National Master Franchisees (franchisor), Regional Master Franchisees (subfranchisors) and Courier Franchisees (subfranchisees). Each country had a separate National Master Franchisee (NMF). NMFs for New Zealand and Australia were wholly owned subsidiaries of FastCo Ltd. The franchisor or NMF for New Zealand recruited and provided support to subfranchisors.

Subfranchisors purchased the right to develop and manage a courier service network within a geographically exclusive area. There were 22 subfranchisors in New Zealand. Subfranchisors were responsible for establishing a depot and recruiting, training and supporting a number of courier franchisees within their exclusive area. Subfranchisors were not able to operate as couriers. Subfranchisors, however, were allowed to own other FastCo subfranchisors. A number did. The largest multi-subfranchisor had four subfranchisor franchises, including one in New Zealand and three in Australia.

Courier Franchisees (or subfranchisees) purchased the rights to operate in an exclusive territory within their respective subfranchisor's territory. The majority of courier franchisees owned and operated a single van. Most others had two. Courier Franchisees in developing areas were purposively granted large territories to attain full market coverage. Overtime, as business developed, such subfranchisees had the opportunity to hire employees or split and sell parts of their territories to new subfranchisees.

Income generated through deliveries and the sale of packaging and labels were shared between the subfranchisee, subfranchisor and franchisor.

### **Development**

In 1983, FastCo's founder began offering courier services personally in the Hawkes Bay region. Ambitious, he sought growth and expanded so that FastCo comprised 12 company-owned vans, operated by employees, by 1984. Despite this growth, the founder felt frustrated by the performance of employee-couriers:

*These had company drivers in them. I found that the productivity levels were nowhere near what I was doing when I started each run. The cost of operating the vehicles were extremely high and I felt there has got to be a better way.*

The founder then decided to franchise operations. Growth and changes to organisational form followed rapidly. FastCo began franchising in 1984 and adopted the single-unit franchising form. All courier runs were converted to franchises and, as stated by the founder, "the productivity levels just increased dramatically. I think about threefold." The founder wanted to grow operations further, so looked beyond Hawkes Bay to the rest of New Zealand. After less than a year, FastCo adopted subfranchising, and a team of two to three franchisor representatives, including the founder, began establishing then franchising subfranchisor operations throughout New Zealand. The founder stated:

*The operation was going really well. We had a five-year business plan - so we basically put phase two into place, which was setting up in other locations. We*



*started in Gisbourne first, and we franchised that, and then we went to Palmerston (North), and we franchised that as a master: We franchised two master territories who had, in turn, courier franchisees underneath them - and then on to Wellington. So, first of all, we would start an operation, find a master franchisee - or a Regional Franchisee, as we call them - and then Courier Franchisees.*

FastCo development continued in New Zealand until 22 subfranchisors and 350 courier franchisees were established.

### ***Franchise Imperatives***

FastCo's franchise development was influenced by a number of factors. FastCo's choice of subfranchising was strongly influenced by the founder's desire for growth. He was particularly ambitious and desired rapid and large-scale growth. That desire for growth under-pinned the adoption of subfranchising and continued on as FastCo looked to establish operations in Australia and Singapore, and advertised for National Master Franchisees in 40 further countries.

The desire to grow highlighted the need for two factors that were critical for growth. The first factor related to internal resources. Specifically, FastCo's founder recognised that FastCo had neither the financial nor managerial resources to realise 1) a nation-wide network of company-owned couriers, or 2), a nation-wide network of company-owned depots to support franchised couriers:

*We realised that we didn't have the human resources to control the operations ourselves. We didn't have enough people in the organisation and we still realised that we had to use our entrepreneurial flair to start the operations. But as soon as we had them up and running we went and found the Master Regional Franchisees...And financial resources, obviously, as well. You know, to set up these operations is very expensive, and if we had have had a company network owned by us, we would never have been able to have the growth that we have got today.*

To the founder, subfranchising was better than all other organisational forms. No other

form provided similar access to financial and managerial resources at both the regional depot and courier level. For example, while single-unit franchising and direct multi-unit franchising forms provide external resources at the courier level, both involved (and therefore required) a company-owned network of regional depot facilities.

The second factor related to the motivation of regional managers and couriers. The founder recognised that in order to achieve growth, both parties needed to be motivated to perform. The founder felt that subfranchising was unparalleled in that it provided both with incentives to perform diligently:

*I think that a master franchisee has to have the total commitment and has to provide the support to the Courier Franchisee and it is a chain of command. Like you have got the Courier Franchisee needs the support of the master, the master franchisee needs the support of the National Master, and then the national master needs the support of the franchisor, and I think that each person along that line has to own and operate that business.*

The founder preferred subfranchising over alternative organisational forms because, by owning their own businesses, it provided regional managers (as subfranchisors) and couriers (as subfranchisees) with good incentives to pursue growth and operate diligently. No alternative franchising arrangement provided similar levels of incentives. To the founder, ownership at each level was essential for growth. Direct multi-unit forms, by comparison, involved a higher proportion of employee couriers. The founder believed that employees do not have the same level of incentives, and are therefore associated with lower growth:

*What actually happens is, when they start employing too many employees, you lose the growth. In franchising people earn on their own performance factor. The harder they work the more money they earn. They have got their capital at risk as well... and, you know, we have experienced that. When we have owned franchises ourselves, the franchises that haven't got employees in them like far outperform the ones that have employees.*

The founder also preferred subfranchising to area representation for incentive-related reasons. He believed that subfranchisors would have greater incentives than area representatives because they have more complete control (i.e., involves less franchisor intervention) over the development of their territories. Furthermore, the founder added that the division of responsibilities associated with area representation would invoke confusion and, potentially, litigation:

*The contractual obligations would just be too messy as to who provides what and it would just leave to much chance for litigation, if you like. You know, "he said we'd do this" and the other one is saying "no that's not what we do, you know."*

## **The Environment**

### ***Market Size***

The market size for courier services was large, providing a number of companies, like FastCo, with the potential to develop networks comprising several hundred couriers. The prospect of a large number of couriers contributed to FastCo's decision to adopt subfranchising. As stated in the previous section, the founder recognised that, in order to achieve desired levels of growth, FastCo needed to introduce external financial and managerial resources. Such resources were essential for developing and managing regional depots and couriers operations.

### ***Market Growth***

The market for courier services has grown. The sector grew rapidly following deregulation during the 1980s. More recently, the founder said, growth had been steady:

*The market had really started to grow. Well, it started to grow back in deregulation days which is back in about the 83, 84 era, and that opened up the market to independents like ourselves and then we just blossomed over night. Then it stagnated for a little while and probably for the last 5 years I would say there has been 7 percent per annum growth... The fast part of the market is the document market, so technology isn't having an effect on that.*

While providing a supportive environment for organisational growth, the founder felt that the actual level of growth did not influence FastCo's decision to use subfranchising. FastCo adopted subfranchising before it was apparent what level of growth could be expected:

*No (the period of large growth did not influence the type of franchising used), because we had set the system when we established the system. So the actual system hasn't been changed. All that we have changed is possibly the method of operandi in between.*

### **Customer Dispersion**

FastCo and other courier company's customers were highly dispersed throughout New Zealand. This meant FastCo required couriers throughout the country. Furthermore, due to degree of isolation from the franchisor, regional depots were also needed:

*Because we are geographically everywhere, we need to have the master type relationship. If we just had one franchise support office to cover the whole country it just wouldn't work. It would be a physical impossibility (Founder).*

Numerous regional depots were required to provide localised coordination, administration and warehousing facilities for couriers. In the mind of the founder, the degree of dispersion meant the costs associated with establishing and managing a network of couriers were high. As identified in a previous section, FastCo lacked the financial and managerial resources to develop a network of couriers and regional depots. Consequently, the founder preferred subfranchising, compared to alternative organisational forms, because it minimised the level of franchisor investment and involvement in establishing and managing both courier and regional depot facilities.

### **Competition**

Competition in the sector has grown and this has impacted on all courier operations. Informants regarded rivalry in the sector as intense, and it became more so overtime. FastCo had four large competitors with nation-wide coverage. There were also numerous small operators and networks with operations confined to particular regions. Increased

rivalry made trading conditions difficult. More competition meant fewer sales and increased discounting led to deteriorating profit margins. The subfranchisor noted the effect of discounting:

*It is a pain because all it does is lower the bar, because we must remain competitive to maintain our market share and sales. But also we must remain profitable.*

As a consequence, some couriers, and smaller courier networks failed. The competitive context contributed to founder's selection of subfranchising:

*I think that I would say that the answer (to how competition has affected the type of franchising selected) would be that the type of system that we have got in place has strengthened our position.*

The founder believed that by subfranchising, and having regional managers and couriers owning their own businesses, both parties would be motivated to operate efficiently and, better identify and respond to customer requirements:

*I think that franchising has enabled us to be very competitive price wise and it has enabled us to adapt to our clients' needs probably quicker than most of the bigger companies... You have got the couriers contract with the customers - but the master assists the courier in offering the best possible service to his clients.*

### ***Customer Diversity and Managerial Complexity***

Customers for courier services were quite homogeneous, providing operators with few challenges. Most customers had similar requirements meaning very little adaptation was required at the courier level. Adaptation that was needed typically involved only large clients, and consisted of adjustments to pricing and/or the frequency of courier visits. For example, the founder said that in most cases:

*It might just be one service a day and in other areas it might be two services a day - or three services - depending on the customer's needs.*

While physically demanding, the tasks associated with managing courier operations were very simple. This uncomplicated format provides couriers with few difficulties. As stated by the founder, several aspects of FastCo operations, including the service breadth and pricing structure, had been purposively designed for simplicity:

*We have always based our business on the KISS principle – 'Keep It Simple Stupid' - and that tends to work; limit the number of services to the bare minimum that you need... Our pricing structure is very simple too.*

There were only eight parcel (two local, four national and two Trans-Tasman) and seven document (one local, four national and two Trans-Tasman) delivery services. That narrow service breadth meant couriers needed only a limited range of labels and document satchels. Further illustrating the simplicity of operating, individual couriers operated in small territories and (typically) followed a set daily route and routine. Very few hired staff.

The homogeneous nature of demand and simplicity of operations had little influence on franchising form. The simplicity of meeting customer needs and operating provided couriers with few managerial challenges. This, in turn, meant couriers were easy to recruit and train. It also meant couriers grew quickly in confidence. Illustrative of this all-round simplicity, the informants stated, in turn:

*Well it is only deliveries and pick-ups. So there is no hard work, the only hard work is lifting heavy cartons (Courier Franchisee).*

*After one week if you haven't got enough basic knowledge to operate we start to be cautious because you can, it is like anything, you can only learn so much and then you must do (Subfranchisor).*

*I don't think it is that complex at all. All they go through is a week's training course which is mainly they'll take a video home and a manual and they will come in the next day and answer a test paper and go out on the road for a couple of days and [then] they are a Courier Franchisee (Founder).*

Overall, the founder felt the level of managerial complexity and customer diversity had no effect on their decision to adopt subfranchising.

### **Summary**

Founded in 1983, FastCo had a network of 22 regional depot facilities and more than 350 couriers throughout New Zealand. FastCo utilised subfranchising. Regional depot facilities were owned and managed by subfranchisors while courier operations were owned and managed by subfranchisees. After founding, FastCo made rapid changes to their organisational form. In 1984, FastCo began franchising with a form characteristic of single-unit franchising. Twelve company-owned units were subsequently converted to franchises. Later, in 1984, FastCo adopted the subfranchising form.

FastCo's founder desired very rapid growth. That desire underpinned much of FastCo's development, including the selection of organisational form. The founder's ambition for growth was evident in his aspiration to not only build a nationwide network of couriers in New Zealand, but also develop extensive courier networks in Australia, Singapore and at least 40 further countries, including the United States. This desire for growth influenced choice of organisational form. FastCo adopted subfranchising for two critical reasons related to growth. First, realising internal resources were limited, FastCo preferred subfranchising because it provided access to much needed external and financial managerial resources. FastCo required these resources to develop a network of couriers and regional depots to support couriers. Second, FastCo preferred subfranchising because, by owning their own businesses, it provided both regional managers and couriers with the motivation to pursue growth and operate diligently.

Franchising form choice was also influenced by factors representing environmental and task uncertainties. The market size, in particular, strongly influenced FastCo's choice of

organisational form. The scale of demand meant the financial and managerial burden associated with recruiting and managing a large number of couriers was high. FastCo then preferred subfranchising over alternatives because, by delegating franchisor-related activities to subfranchisors (or managers of regional depot facilities), it minimised franchisor capital requirements and the managerial burden associated with establishing and managing a large courier network.

Comparatively, market growth had little effect on FastCo's decision to adopt subfranchising. While demand grew steadily, and that growth provided a supportive environment for subfranchising and business growth, the organisational form was selected before market growth rates became apparent.

Customer dispersion influenced form choice more strongly. The need for couriers throughout the country highlighted the costs associated with establishing, managing and monitoring a dispersed courier network. FastCo preferred subfranchising, given the level of dispersion, because they did not have the internal resources to develop the network of couriers and/or regional depot facilities that would be required. Subfranchising enabled FastCo to maximise their size and growth whilst minimising their investment and managerial involvement in regional depot and courier operations.

The level of competition had a minor influence FastCo's decision to adopt subfranchising. Intense rivalry in the sector highlighted the need for diligent management of regional depot and courier operations to operate efficiently and better identify and respond to customer requirements. FastCo preferred subfranchising in that competitive context because it provided both parties with incentives to perform diligently.

The final two factors, customer diversity and managerial complexity had little or no effect on FastCo's choice of organisational form. The influence of these factors was limited to the extent they provided an environment amenable to the utilisation of subfranchising. Moreover, homogeneous demand and simple tasks associated with managing courier operations likely meant that franchisor-related activities, such as courier recruitment, training and on-going management were relatively uncomplicated, and could therefore be delegated effectively to master franchisees.



# CHAPTER 6

## ANALYSIS OF FINDINGS

### Introduction

This chapter explores the results of my thesis. I draw from case descriptions in the preceding three chapters to test the influence of three dimensions of environmental uncertainty (namely, munificence, complexity and dynamism) and task uncertainty on franchising form. In Chapter Two these dimensions or concepts were operationalised by factors that included demand size and growth (environmental munificence), demand dispersion and heterogeneity (environmental complexity), intensity of rivalry (environmental dynamism) and task or managerial complexity (task uncertainty). These factors were then discussed in relation to three categories of franchising forms: 1) single-unit franchising, 2) direct multi-unit franchising and 3), indirect multi-unit franchising. Recall SportCo and MortCo operate single-unit franchising, VideoCo and RealCo operate direct multi-unit franchising, and ServCo, FastCo and SnackCo, either operate, or are intending to operate (i.e., SnackCo), indirect multi-unit franchising forms.

Propositions were generated linking environmental and task-related factors to franchisor choice of franchising form. These propositions are summarised in Table 4.1. This chapter analyses the results in light of each proposition. Following the proposition testing, I outline additional factors that were not part of the conceptual framework but that have influenced franchise form decisions. This chapter then concludes with a section exploring franchisor preferences between the three primary categories of form.

**Table 4.1**  
**Summary of Propositions**

<b>Environmental/Task Dimensions</b>	<b>Propositions</b>
<b>Environmental Munificence</b>	<p><i>Proposition One: When demand size is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.</i></p> <p><i>Proposition Two: When demand size is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.</i></p> <p><i>Proposition Three: When demand growth is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.</i></p> <p><i>Proposition Four: When demand growth is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.</i></p>
<b>Environmental Complexity</b>	<p><i>Proposition Five: When demand heterogeneity is high, the single-unit franchising form will be more prevalent compared to multi-unit forms.</i></p> <p><i>Proposition Six: When demand dispersion is high, multi-unit forms will be more prevalent compared to the single-unit form.</i></p> <p><i>Proposition Seven: When demand dispersion is high, indirect multi-unit forms will be more prevalent compared to direct multi-unit forms.</i></p>
<b>Environmental Dynamism</b>	<p><i>Proposition Eight: When intensity of rivalry is high, single-unit franchising will be more prevalent compared to the multi-unit forms.</i></p>
<b>Task Complexity</b>	<p><i>Proposition Nine: When task complexity is high, the single-unit franchising form will be more prevalent compared to the multi-unit forms.</i></p>

## Environmental and Task Uncertainties and Form Choice

### Environmental Munificence: Demand Size

*Proposition One: When demand size is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.*

Single-unit franchising was the preferred form when demand size was low. MortCo and SportCo supported this proposition (see Table 4.2). Both franchisors placed great value on two key characteristics of single-unit franchising. First, both franchisors felt having owners operate units provided unit managers with good incentives to operate diligently. Second, both franchisors felt that having a direct franchisor-franchisee relationship helped them maintain control of individual units. MortCo and SportCo perceived other types of franchising to be less suitable in terms of providing incentives and maintaining control. Sequential franchising and area development compromised unit-management incentives by involving employee managers. They were also perceived to provide less control. Of the direct multi-unit forms, area development compromised control most.

**Table 4.2**  
**Demand Size and Form Choice**

<b>Firm</b>	<b>Form</b>	<b>Demand Size</b>	<b>Proposition</b>
<b>MortCo</b>	Single-unit	Low	✓
<b>SportCo</b>	Single-unit	Low	✓
<b>VideoCo</b>	Sequential	Moderate	✓
<b>RealCo</b>	Sequential/Area Dev.	Moderate	✓
<b>SnackCo</b>	Area representation	Moderate	✓
<b>ServCo</b>	Subfranchising	High	✓
<b>FastCo</b>	Subfranchising	High	✓

✓ = Supported    ✗ = Not Supported

Due to a small market size, both MortCo and SportCo required relatively few units in order to reach full market penetration. Tasks associated with recruiting and establishing

units were therefore less than if market size, and the number of units required, were greater. Consequently, MortCo and SportCo placed little value on advantages normally associated with direct forms, such as increased growth in units through lower establishment costs.

The level of market or demand size also influenced MortCo and SportCo's feelings toward both indirect multi-unit franchising forms, namely area representation and subfranchising. Franchisor informants from both companies considered their market size to be too small to merit using those forms. More specifically, they felt that area representation and subfranchising offered more benefits to systems with very high demand size. In contrast, MortCo and SportCo felt that indirect forms could offer them few advantages over single-unit franchising. Furthermore, they believed that demand size was insufficient for either area representation or subfranchising to be viable. MortCo and SportCo were concerned that demand was insufficient in size to cover additional costs associated with having master franchisees. Importantly, VideoCo, RealCo and SnackCo, also echoed similar concerns regarding the viability of area representation and/or subfranchising forms, due to low market size.

Both VideoCo and RealCo utilised direct multi-unit forms, sequential franchising and/or area development. This also supports the proposition. In line with the proposition, both considered their demand context of a size that market penetration could be more readily achieved and managed by allowing competent owners to hold additional franchises. Moreover, RealCo, in particular, indicated the burden associated with recruiting and establishing new owners for each additional office would be too restrictive on chain growth. Thus, limiting franchisees to a single franchise appeared nonsensical. Importantly, however, while demand size was too large for single-unit franchising, both companies considered it insufficient for indirect multi-unit forms, such as area representation and subfranchising. Further, both companies considered their context far from a threshold whereby indirect multi-unit franchising forms would warrant more serious consideration. Consequently, the choice between direct and indirect forms for VideoCo and RealCo was based, in part, on demand size.

With large demand size, and much greater potential for units, ServCo and FastCo (with

more than 500 and 350 units, respectively), particularly, but also SnackCo, favoured indirect multi-unit forms. This preference supported the proposition. SnackCo was converting operations from single-unit franchising to area representation because it considered its market capacity to be too large for single-unit franchising. Interestingly, while SnackCo considered its market too large for single-unit franchising, it felt it was too small for subfranchising. In contrast, both ServCo and FastCo perceived themselves, and their market, too large for all forms (including direct multi-unit forms) apart from subfranchising. FastCo and ServCo's franchisor informants felt that, given the size of their respective markets, operating area representation, subfranchising's closest variant, would be impractical. The tasks involved with franchise recruitment, alone, would be too burdensome to centralise. Thus, these larger systems preferred to delegate a greater proportion of franchisor related activities, including unit-franchisee recruitment, training and ongoing support, to third party subfranchisors. ServCo and FastCo believed that delegating such activities obviated the cost and risk associated with developing a large head office, but also resulted in better management of unit-franchisees and faster growth. Specific to their analyses of direct multi-unit forms, ServCo, FastCo and SnackCo also highlighted motivational issues. Specifically, owner-involvement was regarded as essential to the success of their units. Both companies felt direct multi-unit forms compromised the motivational incentives and advantages provided by owner-involvement.

To conclude, the evidence provided support for Proposition One. The relationship between demand size and choice of franchising form coincided with expectations derived from the model. Multi-unit forms were more prevalent, compared to single-unit franchising, when demand size was high. When demand was high franchisors were willing to trade-off franchisor control, over individual units, in exchange for lower *ex ante* costs. Conversely, when demand was low franchisors opted to recruit and manage franchisees centrally in exchange for lower *ex post* costs.

*Proposition Two: When demand size is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.*

There was some support for Proposition Two. The choice between direct and indirect multi-unit franchising forms was, in part, mediated by franchisor strategic choice. In the

context of demand size, those franchisors opting for direct over indirect multi-unit forms were influenced by the desire or need to minimise standardisation costs. Importantly, VideoCo and RealCo perceived their markets to be insufficient in size for indirect forms to be viable. In contrast, franchisors adopting indirect multi-unit forms over direct multi-unit forms were influenced by the desire to minimise motivational costs. That is, franchisors utilising indirect forms preferred having owners than employees managing units because they felt owners were more motivated. Importantly, however, the franchisors desire to minimise motivational costs was not specifically related to the level of market or demand size.

In summary, the findings were generally supportive of the proposed relationship between demand size and choice of organisational form. Multi-unit forms were more prevalent compared to single-unit franchising when demand size was high. Additionally, the choice between direct and indirect multi-unit franchising forms was mediated, to some extent, by franchisors strategic choice. In the context of demand size, those franchisors adopting direct over indirect forms did so, in part, to minimise standardisation costs. For franchisors utilising indirect forms, the level of market size did not influence the choice between direct and indirect forms.

### **Environmental Munificence: Demand Growth**

*Proposition Three: When demand growth is high, multi-unit franchising forms will be more prevalent compared to the single-unit form.*

The cases of ServCo and FastCo supported the theoretical proposition (see Table 4.3). In a context of high demand growth, both preferred subfranchising to alternative forms for its capacity to facilitate more rapid unit-growth. Informants from these systems highlighted the advantages subfranchising provided by allowing them to focus limited financial and managerial resources on recruiting and training subfranchisors that, in turn, recruit, train and support subfranchisee operators in their respective territories. For these companies, the scale of demand growth, combined with their desire for rapid growth, and the potential for large numbers of operators, was such that all alternative franchising forms were considered impractical, and therefore were outright rejected. Those forms rejected

included area representation, subfranchising's closest variant. ServCo, in particular, highlighted the operational implications (e.g., in franchise recruitment with up to 30-40 enquiries from prospective subfranchisees each day) centralising certain franchise system management functions could have on scarce franchisor resources. Both companies also rejected area development, another master franchise form, because they perceived units, run by employees (instead of owners), would provide lower sales growth. Subfranchising, in contrast, was perceived to provide better incentives for growth at both the subfranchisor and subfranchisee (unit) level.

**Table 4.3**  
**Demand Growth and Form Choice**

<b>Firm</b>	<b>Form</b>	<b>Demand Growth</b>	<b>Proposition</b>
<b>MortCo</b>	Single-unit	Large	×
<b>SportCo</b>	Single-unit	Small	✓
<b>VideoCo</b>	Sequential	Small from large	✓
<b>RealCo</b>	Sequential/Area Dev.	Turbulent	×
<b>SnackCo</b>	Area representation	Large	✓
<b>ServCo</b>	Subfranchising	Very large	✓
<b>FastCo</b>	Subfranchising	Very large	✓

✓ = Supported    × = Not Supported

The case of SnackCo also supported the theoretical proposition. SnackCo commenced franchising with single-unit franchising. SnackCo operated in a market that was growing rapidly but found its own growth frustratingly slow. SnackCo then opted for area representation to facilitate growth. Interestingly, the founder felt that the utilisation of area representation would be temporary. He planned to revert back to single-unit franchising when growth in the market slowed down.

The case of SportCo supported the theoretical proposition. In the context of earlier steady demand growth, SportCo concentrated somewhat more on growth in store numbers, and a small number of existing franchisees were allowed to establish an additional outlet. More

recently, however, slowing growth, and therefore a more challenging operating environment, has highlighted the importance of providing adequate incentives to store managers. Consistent with expectations, SportCo preferred forms that maximised owner-involvement in individual stores. Consequently, SportCo preferred single-unit franchising to direct multi-unit forms and the Franchise Partnership Structure was preferred to sequential franchising.

The case of VideoCo provided some further support. Sequential franchising dominated VideoCo's form during the period of early steady market growth. Interestingly, however, the choice of direct multi-unit franchising was motivated more by ambitious initial franchisees wanting more than one outlet, than the franchisor. More recently, demand growth has faltered. Franchisee reactions to reduced growth illustrated the importance of demand growth on franchising type. Some multi-unit franchisees reduced the size of their networks and invested in alternative opportunities outside the video hire sector.

RealCo's choice of direct multi-unit franchising did not support the proposition. Contrary to expectations (see Table 4.3), RealCo adopted a form that facilitated rapid unit-growth despite demand in its sector oscillating wildly, sometimes by more than 15 percent on the previous year. Indeed, RealCo sought very rapid unit-growth, leading to the rejection of single-unit franchising. In a context where one might have expected single-unit franchising to be more appropriate, it was rejected because it slowed growth and was burdensome on franchisor resources. Sequential franchising and area development were preferred because they facilitated more rapid growth.

RealCo's subsequent experiences, and more recent plans, however, do support the proposition. RealCo's context of volatile demand has highlighted inefficiencies associated with direct multi-unit forms. Specifically, low periods have highlighted the poor performance of employee-managed, compared to owner-managed, RealCo offices. Consistent with expectations, RealCo is now looking to limit franchisee expansion and size, thereby increasing the proportion of owner-managed to employee-managed offices.

Like RealCo, MortCo also failed to support the proposition. Despite a backdrop of strong demand growth, MortCo chose not to adopt a form that facilitated rapid growth. Instead,



MortCo selected single-unit franchising. That departure from my proposition illustrated that there were other important factors contributing to organisational form decisions. Notably, for MortCo, the franchisor attributed high levels of importance on other factors. For example, the franchisor exhibited a strong desire to maintain high levels of power and control in their relationship with franchisees. The franchisor perceived alternative types of franchising to compromise control. Other reasons were also prominent. For example, limited demand size and increased competitive activity highlighted viability concerns associated with indirect forms. MortCo also associated concerns with direct multi-unit franchising forms. In particular, MortCo believed having employee-based consultants, instead of more motivated owner-operating consultants, reduced the potential for unit-level growth.

In summary, the concept of demand growth possessed some utility in explaining the usage and consideration of different franchising forms. Consistent with expectations derived from the model, companies such as ServCo, FastCo, SnackCo and VideoCo adopted growth facilitating multi-unit forms in a context where demand growth is/was strong. Also in line with the proposition, companies featuring low and even negative demand growth favoured single-unit franchising. In contrast, however, the initial development of form in two cases occurred contrary to expectations. With strong demand growth, MortCo maintained the single-unit form. Conversely, with volatile demand, RealCo adopted growth-facilitating forms. For RealCo, however, it is important to note that they were revising their franchise strategy to an organisational form that supported the proposition.

*Proposition Four: When demand growth is high, the choice between direct and indirect forms will be mediated by the franchisor's strategic choice.*

Proposition Four was only partially supported. Following the proposition, firms adopting indirect over direct multi-unit forms clearly valued more rapid growth, through lower motivational costs, over reducing costs associated with standardisation. SnackCo, ServCo and FastCo, operating in a context of growing demand, all felt that having owners operate units was critical to achieving concomitant organisational growth. Companies adopting direct multi-unit forms, however, did not support the proposition. While both VideoCo and RealCo rejected indirect multi-unit forms based on cost, their preference for direct multi-

unit franchising was not specifically related to the level of demand growth. In other words, the level of demand growth did not influence their decision to adopt a direct versus indirect multi-unit franchising form.

Overall, there was some support for both propositions, although Proposition Three was more strongly supported than Proposition Four. Demand growth influenced form choice in a number of cases. Companies operating in rapidly growing environments generally did prefer multi-unit forms for their capacity to facilitate growth. Meanwhile, companies facing low and even negative demand growth favoured single-unit franchising. Two companies, however, adopted forms contrary to expectations. Of these, one added further support to Proposition Three by experiencing difficulties consistent with the logic underlying the propositions. The second illustrated how no one factor explains form choice; instead, multiple factors may work in concert.

Choices made between indirect and direct multi-unit forms were only partially consistent with Proposition Four. In a context of high growth, companies utilising indirect multi-unit forms preferred forms capacity to facilitate rapid growth to their ability to reduce standardisation costs. For franchisors utilising direct multi-unit forms, the level of demand or market growth did not influence the choice between direct and indirect forms.

### **Environmental Complexity: Demand Heterogeneity**

*Proposition Five: When demand heterogeneity is high, the single-unit franchising form will be more prevalent compared to multi-unit forms.*

SportCo and MortCo strongly support the proposition (see Table 4.4). Both companies operated in an environment where demand was quite heterogeneous. SportCo and MortCo preferred single-unit franchising to both direct and indirect multi-unit forms for its capacity to balance requirements for adaptation with system-wide uniformity.

**Table 4.4**  
**Demand Heterogeneity and Form Choice**

<b>Firm</b>	<b>Form</b>	<b>Heterogeneity</b>	<b>Proposition</b>
<b>MortCo</b>	Single-unit	Heterogeneous-Homogeneous	✓
<b>SportCo</b>	Single-unit	Heterogeneous	✓
<b>VideoCo</b>	Sequential	Heterogeneous-Homogeneous	✓
<b>RealCo</b>	Sequential/Area Dev.	Heterogeneous-Homogeneous	×
<b>SnackCo</b>	Area representation	Homogeneous	✓
<b>ServCo</b>	Subfranchising	Homogeneous	✓
<b>FastCo</b>	Subfranchising	Homogeneous	✓

✓ = Supported    × = Not Supported

Heterogeneous demand provided SportCo and MortCo with considerable operational challenges. SportCo needed store managers who were especially diligent. Diligent store managers were required to effectively manage stock in an environment where customer requirements varied widely. Similarly, MortCo also needed consultants who were diligent in order to accurately determine and match lending products with the diverse circumstances and requirements of property investors. Yet, while units of both systems were required to adapt and respond to varying needs, they also needed to exhibit a degree of uniformity and consistency. Compared to single-unit franchising, MortCo and SportCo indicated that that balance would be more difficult to achieve with direct or indirect multi-unit forms. Direct multi-unit forms were perceived to reduce the capacity for local adaptation. In keeping with agency theory, the need for local adaptation highlighted the importance of incentives. Both companies believed owners were more motivated than employees to operate units diligently. Accordingly, franchising forms that reduced owner-involvement were rejected on the basis that employee-managers would lack the motivation to respond to individual customer needs. Consequently, MortCo and SportCo preferred single-unit franchising to direct multi-unit forms. MortCo also, in particular, believed that indirect multi-unit forms reduced their ability to maintain uniform systems and standards. MortCo was concerned that local master franchisees - whether area representatives or subfranchisors - would be motivated, due to business ownership, to adapt units within their

territory, to that territory. MortCo was particularly concerned that such adaptation would occur at the expense of maintaining adequate levels of system-wide uniformity and consistency. Consequently, MortCo preferred single-unit franchising to indirect multi-unit forms because it provided the franchisor with greater power to ensure local adaptation was balanced with appropriate levels of standardisation.

Companies operating in environments featuring more homogeneous demand also adopted forms that were consistent with the proposition. These companies placed less emphasis on the importance of incentives provided by owner-involvement, bargaining power relative to franchisees, and/or maintaining a direct relationship with all unit-managers/operators, and adopted direct or indirect multi-unit franchising forms. This section will consider the prevalence of direct multi-unit franchising first, before considering indirect multi-unit franchising. In doing so, I uncovered an additional explanation for the choice between direct and indirect multi-unit forms.

VideoCo and RealCo utilised direct multi-unit forms. Of these, one might confidently suggest VideoCo featured more homogenous demand than MortCo and SportCo, who utilised single-unit franchising. It was less clear, however, given the difficulty of directly comparing different business concepts, whether RealCo featured more or less homogeneous demand than both MortCo and SportCo.

Consistent with the model, VideoCo had some variation in and across stores and that provided only a minor impact on the nature and complexity of operating. The lack of heterogeneity meant the challenges associated with simultaneously maximising local responsiveness whilst maintaining a degree of standardisation were low. In this sense, it appeared the level of homogeneity decreased constraints pertaining to form that might otherwise be associated with more heterogeneous demand. Indeed, one might suggest that the characteristics associated with form that were so important in a heterogeneous environment, such as maximising owner-involvement in units, were of less importance in VideoCo's more homogeneous environment. Consequently, one might suggest that an environment featuring homogeneous demand, such as VideoCo's was amenable for direct multi-unit franchising.

RealCo's utilisation of sequential franchising and area development did not support the proposition. RealCo, in contrast to VideoCo, utilised direct multi-unit franchising forms in an environment with greater diversity of demand. That increased diversity meant the tasks associated with balancing local adaptation with system-wide standardisation were more challenging. Of both challenges, RealCo was particularly concerned with maintaining a degree of consistency and uniformity across locations.

Consistent with expectations derived from the model, RealCo's utilisation of direct multi-unit forms was problematic. RealCo's experiences demonstrated that franchisees with multiple offices were powerful and that power directly and indirectly impeded the effective implementation and monitoring of initiatives intended to benefit the overall chain. Those experiences subsequently contributed to RealCo's decision to limit franchisee size and expansion. Thus, while RealCo operated direct multi-unit franchising, they indicated a preference for single-unit franchising.

RealCo further increased my understanding of form choice in their context of demand heterogeneity. RealCo preferred direct to indirect multi-unit franchising forms in that environment. RealCo believed indirect multi-unit franchising would reduce their ability to balance local responsiveness with standardisation. RealCo felt that area representatives or subfranchisors would be more motivated - because of residual claims tied to their performance - to make local adaptations than appreciate system-wide efforts and benefits associated with standardisation.

The utilisation of indirect multi-unit forms by SnackCo, ServCo and FastCo also supported the proposition. These three companies operated in environments featuring relatively homogeneous demand. In keeping with expectations, this level of homogeneity appeared to reduce ex-post costs. Accordingly, the challenges associated with managing the conflicting demands of local responsiveness and standardisation were relatively minor. In turn, it appeared, this context of homogeneity ameliorated disadvantages (e.g., less direct contact and control over individual units) otherwise associated with utilising indirect forms, particularly when compared to single-unit franchising. In other words, it seemed that SnackCo, ServCo and FastCo operate in an environment - in terms of demand heterogeneity - that is amenable to indirect multi-unit franchising.

In summary, the cases provided general support for the proposition. The forms utilised by the companies were largely consistent with my expectations. Ex-post costs associated with local adaptation and standardisation were crucial in firms facing heterogeneous compared to homogeneous demand. Correspondingly, companies preferred forms in fit with their context. Indeed, companies experiencing higher levels of demand heterogeneity preferred single-unit franchising because it preserved unit-level incentives, bargaining power and a direct relationship. Companies considered those characteristics vital for management issues pertaining to ex-post costs. By contrast, ex-post costs were less crucial for companies experiencing more homogeneous demand. More homogeneous demand reduced the managerial challenges associated with balancing local responsiveness and standardisation. Consequently, the disadvantages that might otherwise be associated with adopting multi-unit forms (when compared to single-unit franchising) were reduced. Companies experiencing more homogeneous demand could be less constrained in their choice of form.

Consideration of demand heterogeneity and form choice produced an additional explanation for the choice between direct and indirect multi-unit forms. One company, namely RealCo, operating direct multi-unit franchising in an environment featuring heterogeneous demand, identified relative disadvantages associated with indirect multi-unit franchising forms. RealCo believed indirect forms would reduce their ability to establish and maintain standard operating practices.

### **Environmental Complexity: Demand Dispersion**

*Proposition Six: When demand dispersion is high, multi-unit forms will be more prevalent compared to the single-unit form.*

FastCo and ServCo supported the proposition (See Table 4.5). Both companies utilised subfranchising in a context where demand was very highly dispersed. Those high levels of dispersion highlighted the substantial costs associated with the establishment and management of large numbers of geographically isolated operators. Both companies stated that it would be physically impossible to provide all aspects of franchise system

management from a centralised location. Consequently, effectively achieving these management tasks required localised management. Subfranchising was preferred in this context for its capacity to minimise these costs.

Comparatively, both FastCo and ServCo regarded all alternative forms as impractical. Through more completely delegating franchise system management tasks to subfranchisors, subfranchising meant both companies could focus scarce resources on recruiting and training subfranchisors who, in turn, recruit and provide ongoing management to unit-level franchisees (in different areas throughout the country). Neither company had the financial or managerial resources to centralise such functions, nor to establish a regional network of employee managers. But also, importantly, neither company indicated they would like to establish company-owned operations. Both valued the fact subfranchising provided regional managers (as subfranchisors) with business ownership. FastCo and ServCo thought employee regional managers lacked the incentives to perform establishment and management tasks diligently. The logic for this was explicit and clearly followed agency theory. Furthermore, it was consistent with the proposition that forms will be adopted that minimise ex ante and ex post costs [which are high] when the level of customer or demand dispersion is very high.

**Table 4.5**  
**Demand Dispersion and Form Choice**

<b>Firm</b>	<b>Form</b>	<b>Dispersion</b>	<b>Proposition</b>
<b>MortCo</b>	Single-unit	Low	✓
<b>SportCo</b>	Single-unit	Moderate	✓
<b>VideoCo</b>	Sequential	Moderate	✓
<b>RealCo</b>	Sequential/Area Dev.	High	✓
<b>SnackCo</b>	Area representation	Moderate	✓
<b>ServCo</b>	Subfranchising	Very high	✓
<b>FastCo</b>	Subfranchising	Very high	✓

✓ = Supported    ✗ = Not Supported

ServCo provided additional evidence in support of the proposition. ServCo executives stated that if their units were more geographically concentrated, in an area such as Auckland, they would be inclined to adopt single-unit franchising. That geographic concentration would better enable them to centralise activities associated with franchise system management.

SnackCo's transition from single-unit franchising to area representation also supported the proposition. SnackCo identified that the costs associated with establishing, but particularly managing dispersed operators, with single-unit franchising, in an environment where demand was dispersed, were prohibitively high. Furthermore, SnackCo perceived that centralising both activities, whether by performing all franchisor-related functions from a central location or having regional managers employed by the franchisor, limited the effectiveness of their provision. Consistent with expectations, SnackCo preferred area representation. Given the level of dispersion, SnackCo felt area representatives could cost effectively provide both localised and diligent support to dispersed unit-level franchisees.

VideoCo and RealCo provided partial support for the proposition. With medium to large numbers of dispersed operators both have adopted direct multi-unit forms. Of these companies, RealCo, in particular, articulated a philosophy in line with expectations. That is, they were more likely to allow franchisees, which were isolated from the franchisor or regional offices to expand. RealCo allowed such expansion because dispersed units were perceived to be expensive to establish. VideoCo and RealCo's preference for direct multi-unit forms over indirect multi-unit forms also supported the proposition. While both have established a network of employee regional managers to provide localised support and co-ordination to franchisees, neither considered demand dispersed enough to warrant adopting indirect-multi-unit forms.

Finally, the cases of MortCo and SportCo also supported the proposition. Both companies utilise single-unit franchising in a context of low to moderate dispersion. Challenges associated with the dispersion of operators have influenced form choice at MortCo and SportCo. MortCo indicated difficulties establishing dispersed units, and both companies experienced problems co-ordinating, observing and controlling dispersed units. These challenges influenced form decisions and preferences. For SportCo, initial company-



owned expansion into dispersed areas produced problems. Employee-managed units performed poorly and required considerable monitoring. SportCo preferred single-unit franchising because it reduced these problems, and therefore reduced costs, by instituting owner-managers who make more diligent managers. MortCo's choice of form was also influenced by the dispersion of demand. While advantages were associated with indirect multi-unit forms, and minor anomalies existed, single-unit franchising was ultimately preferred and prevalent. In terms of alternative forms, MortCo's founder perceived indirect multi-unit forms could reduce difficulties and costs associated with the establishment and management of dispersed units. Regarding anomalies, MortCo was more likely to customise franchise agreements in small and very isolated markets that were relatively expensive to support. Importantly, however, despite these perceptions and anomalies, MortCo accepted that their dominant form, single-unit franchising, was optimal given the level of dispersion.

In summary, general support was found for Proposition Six. Multi-unit forms were selected when demand dispersion was moderate to high and, single-unit franchising was selected when demand dispersion was moderate to low.

*Proposition Seven: When demand dispersion is high, indirect multi-unit forms will be more prevalent compared to direct multi-unit forms.*

The cases provided some support for Proposition Seven. The two companies operating in very highly dispersed environments, namely ServCo and FastCo, did adopt indirect multi-unit forms. Furthermore, their decision to adopt indirect forms was influenced by the level dispersion. ServCo and FastCo regarded all alternative forms as impractical in this environment. Companies in moderate to high dispersion environments made less decisive decisions pertaining to form choice. For example, three companies operating in moderately dispersed environments, namely SportCo, VideoCo and SnackCo, adopted single-unit franchising, sequential franchising (direct multi-unit franchising) and area representation (indirect multi-unit franchising), respectively.

## Environmental Dynamism: Intensity of Rivalry

*Proposition Eight: When intensity of rivalry is high, single-unit franchising will be more prevalent compared to the multi-unit forms.*

The findings lent only partial support for the proposition. Only three firms adopted forms consistent with expectations. Indeed, while six of seven cases operated in intensely competitive environments, only two cases (MortCo and SportCo) preferred and operated single-unit franchising.

**Table 4.6**  
**Intensity of Rivalry and Form Choice**

Firm	Form	Intensity of Rivalry	Proposition
MortCo	Single-unit	Intense	✓
SportCo	Single-unit	Intense	✓
VideoCo	Sequential	Intense	×
RealCo	Sequential/Area Dev.	Intense	×
SnackCo	Area representation	Benign-Intense	✓
ServCo	Subfranchising	Intense	×
FastCo	Subfranchising	Intense	×

✓ = Supported    × = Not Supported

Both MortCo and SportCo supported the proposition (see Table 4.6). Both companies operated in a highly competitive context and preferred single-unit franchising. As expected, their competitive context highlighted the need for unit-level and system-wide efficiencies. MortCo and SportCo identified advantages associated with single-unit franchising in these areas. They identified that compared to direct multi-unit forms, single-unit franchising provided managers who, because they were owners, were motivated to operate diligently and make a success of their respective businesses. MortCo and SportCo also identified that, compared to indirect multi-unit forms, single-unit franchising was a

more efficient structure for their franchise systems. In particular, these companies felt that centralising rather than duplicating franchisor-related activities across different markets was more efficient and incurred fewer system-wide costs. SportCo also felt that maintaining a direct franchisor-franchisee relationship was important for communicating and acting on market information in a competitive environment.

The case of SnackCo was also consistent with the proposition. In contrast to other cases, SnackCo operated in a relatively benign competitive environment. In this context, SnackCo was making a transition from single-unit franchising to area representation in order to facilitate more rapid growth. The founder was concerned that considerable unrealised market potential existed and that if SnackCo did not seize it their competition would. SnackCo's utilisation of area representation was consistent with the proposition. One might consider SnackCo's relatively benign competitive context as amenable for multi-unit franchising.

RealCo and VideoCo did not support the proposition (see Table 4.6). Both companies operated direct multi-unit franchising in environments that were intensely competitive. Their respective competitive environments had little or no notable influence on the original decision to adopt these forms. Importantly, however, changes to both RealCo and VideoCo's franchising forms had, more recently, been influenced by their competitive contexts. In fact, RealCo's most recent franchise strategy did support the theoretical proposition. RealCo's context, which included widespread price competition, falling profit margins, and product differentiation, exposed two important disadvantages associated with their utilisation of direct multi-unit franchising forms. First, in a context where office-level productivity and efficiency was paramount, the General Manager concluded that offices controlled by multi-unit franchisees performed poorly compared to offices owner-operated offices. Second, multi-unit franchisees had greater bargaining power that frustrated the franchisor's attempts to implement new initiatives and monitor offices; franchisor-related responsibilities that were intended to benefit the system. Supporting the proposition, these problems contributed to RealCo's recent intentions to limit franchisee size and expansion. Intensity of competition also contributed to changes in VideoCo's franchising form. Specifically, multi-unit franchisees were selling some of their outlets to new franchisees – thus increasing VideoCo's proportion of owner-managed outlets. In contrast to RealCo,

however, VideoCo's changes to form were not instigated by the franchisor. Instead, the changes were driven by the desires and actions of VideoCo's large franchisees that wanted to reduce their financial exposure in the video hire sector.

FastCo and ServCo did not support the proposition. Both companies operated subfranchising in very competitive sectors. The operation of subfranchising departed from expectations: I proposed that single-unit franchising would be more prevalent when rivalry was intense. Importantly, FastCo and ServCo's utilisation of subfranchising does follow, in part, the total logic underlying the proposition. Subfranchising does, like single-unit franchising, preserve efficiencies at the unit-management level by involving owner-operators. Maintaining diligent operators at the unit-level was important for both companies.

FastCo and ServCo's utilisation departed from expectations because, according to the theoretical model, it introduced two primary disadvantages: 1) subfranchising reduces franchisor power needed for influencing and monitoring system-wide adaptations, and 2) subfranchising increases standardisation costs by adding hierarchy and replicating the provision of franchisor-related activities in different regions. Interestingly, however, both companies felt that subfranchising was optimal. For example, ServCo was most concerned with establishing units more rapidly than competitors, particularly for new services. ServCo therefore preferred subfranchising for its capacity to facilitate very rapid growth. FastCo, by contrast, preferred subfranchising because it felt the subfranchising form enabled them to be both more efficient and responsive than competitors.

In summary, the findings lend only partial support for the proposition. Only three of seven companies preferred and operated organisational forms that were consistent with expectations. Indeed, of the six companies that operated in intensely competitive environments, only two utilised single-unit franchising. Of these, however, it is important to note that one company experienced problems consistent with a form-factor misfit. Further supporting the proposition, that company was motivated to modify its franchise strategy.

### **Task Uncertainty: Task Complexity**

*Proposition Nine: When task complexity is high, the single-unit franchising form will be more prevalent compared to the multi-unit forms.*

MortCo and SportCo supported the proposition (See Table 4.7). Both companies utilised single-unit franchising in environments featuring high levels of task uncertainty. The high levels of managerial complexity associated with operating their respective business units meant both companies considered single-unit franchising to be advantageous compared to alternative franchising forms. The complexities associated with a large stock range (e.g., at SportCo) and/or complex product/service delivery (e.g., at MortCo) variously highlighted the importance of activities associated with managing task complexity. These activities were related to ex ante and ex post costs and included recruiting quality unit-managers, good unit-management decision-making and ensuring the quality of training and support. MortCo and SportCo preferred single-unit franchising because, when compared to alternative forms, it preserved the integrity associated with each of these activities. As expected, two characteristics of single-unit franchising were of central importance. First, single-unit franchising involved owner-operators in units/stores. Second, single-unit franchising maintained a direct franchisor-franchisee relationship. Maintaining this direct relationship meant the franchisor performed all activities, such as franchise recruitment, training, monitoring and support.

SportCo felt that preserving owner-involvement in units was vital. Owner-managers were regarded as more motivated and diligent than employees, and diligent managers were considered essential given the mental and physical effort required to manage SportCo's complex operations. Furthermore, turnover among franchisees was typically lower than employee-managers. Having owner-operators then meant that store managers were typically more experienced, and experience was an advantage given the complexity of, and time taken to learn, store operations.

SportCo and MortCo also valued a direct franchisor-franchisee relationship. Both companies wanted to maintain control of recruitment, given the complexity of operations. MortCo also wanted to maintain control of training. Both recruitment and training activities were regarded as crucial given the complexity of their business concept.

**Table 4.7**  
**Task Complexity and Form Choice**

<b>Firm</b>	<b>Form</b>	<b>Complexity</b>	<b>Proposition</b>
<b>MortCo</b>	Single-unit	Complex-Very Complex	✓
<b>SportCo</b>	Single-unit	Very Complex	✓
<b>VideoCo</b>	Sequential	Complex	✓
<b>RealCo</b>	Sequential/Area Dev.	Complex	✓
<b>SnackCo</b>	Area representation	Simple	✓
<b>ServCo</b>	Subfranchising	Simple	✓
<b>FastCo</b>	Subfranchising	Simple	✓

✓ = Supported    ✕ = Not Supported

VideoCo and RealCo also supported the proposition. Both operated direct multi-unit franchising and were prima facie less complex than SportCo and MortCo. Comparatively, VideoCo appeared less complex than RealCo. The relative complexity (or simplicity) of VideoCo placed less emphasis on activities (e.g., recruiting quality unit-manager) and attributes (e.g., owner-involvement) that were essential in more complex businesses. Consequently, this context rendered VideoCo's format more amenable to direct multi-unit franchising. Supporting that view, VideoCo informants identified few disadvantages that could be associated with direct multi-unit franchising, given the level of complexity. On the other hand, RealCo informants were more concerned about the quality of recruitment and training of unit-managers. Furthermore, RealCo indicated greater concern about the ability of franchisees to successfully manage multiple units. Despite these differences, both were united in their preference for direct over indirect multi-unit franchising forms in this context. Neither were comfortable delegating tasks associated with franchise system management to master franchisees.

Finally, SnackCo, ServCo and FastCo also supported my proposition. These three companies featured the lowest levels of task uncertainty and either operated (FastCo and ServCo) or were about to adopt (i.e., SnackCo) indirect multi-unit franchising forms. Units of these franchise systems were characterised by simplicity. Their concepts were

comparatively simple and required little training in methods of operation. Indeed, their tasks were repetitive, most training was on-the-job (as opposed to institutional) and new recruits developed operating confidence quickly. In turn, FastCo and ServCo, in particular, acknowledged that the level of simplicity associated with managing their units, and recognised that this assisted their ability to delegate tasks, such as recruitment, training and monitoring to independently owned and operated master franchisees. Further, they argued that this delegation of franchisor-related activities was achieved with little or no loss in quality.

In summary, the choice of different franchising forms coincided with my expectations. The single-unit form was more prevalent than multi-unit forms when task uncertainty was high. On the other hand, companies encountering less task uncertainty adopted multi-unit forms.

## ADDITIONAL FACTORS AND FRANCHISING FORM

The qualitative design used in this study highlighted the importance of factors that were not part of my theoretical model. These consisted of individual and firm-specific factors. Factors specific to individual choice included franchisor perceptions of incentives, growth aspirations and need for control. Firm specific factors included resource constraints and franchisee aspirations (See Table 4.8).

**Table 4.8**  
**Individual and Firm-Level Determinants of Form Choice**

	MortCo	SportCo	VideoCo	RealCo	SnackCo	ServCo	FastCo
	<i>Single-Unit</i>		<i>Direct Multi-Unit</i>			<i>Indirect Multi-Unit</i>	
<i><b>Individual Choice</b></i>							
Incentives	1	1	2	2	1	1	1
Growth Aspirations	2	2	-	1	2	1	1
Need for Control	1	-	2	2	2	-	-
<i><b>Firm-Specific</b></i>							
Resource Constraints	-	1	-	1	1	1	1
Franchisee Aspirations	-	2	1	1	-	-	-

Notes: 1 = very important in form decisions  
2 = important in form decisions  
- = not important in form decisions

### Individual Choice

As decision-makers, the founders and/or key franchisor personnel had an important impact on decisions pertaining to franchising form choice. The findings illustrated that franchisor decision-makers had different aspirations, beliefs, preferences, levels of knowledge and logic. Those differences, in turn, influenced franchising form choices in myriad ways. In this section, I highlight three important factors, relating to individual choices, which influenced franchising decisions.

#### *Incentives*

Incentives played a crucial role in franchising decisions. Incentives were critical both in the initial decision to franchise and the selection of franchising forms thereafter. While



this study is concerned most with choice of franchising forms, it is important to also consider the role of incentives in the initial decision to franchise. That is because the rationale for franchising, when coupled with the immediate experiences thereafter, often influenced subsequent decisions pertaining to franchising form.

A level of discontent preceded the decision to franchise in most companies. Many of them had attempted to expand through hiring employees. Some such as, MortCo, had also experimented with alternative forms of remuneration in an attempt to improve unit performance. Looking back, all companies shared a common feeling that there had to be a better way of organising the management of their units to achieve both growth and unit-performance. Most felt productivity was poor and, in fact, the founders of many companies (e.g., SportCo, MortCo, ServCo and FastCo), who started as owner-operators, were frustrated that employee-managers never met performance standards they had set for themselves. Furthermore some, such as SportCo, harboured more negative associations with employee-managers, after bad experiences with staff dishonesty and theft.

Franchising offered an opportunity to better motivate unit-operators. Most franchisors hoped that having owners, rather than employees, operating units would improve the performance of unit-level management. Corresponding with the concept of moral hazard in agency theory (Brickley & Dark, 1987; Combs & Ketchen, 1999; Rubin, 1978), franchisor informants believed that franchisees that invested in units would be less likely to free ride and shirk. Put differently, owners would be more motivated to make a success of their unit/s. For all concerned, franchised units did, on average, perform better than company-owned units managed by employees and for most companies, that result confirmed the logic that led them to franchise. Further, it informed many companies evaluation of alternative franchising arrangements. It is important to note at this stage, however, that while owner-operators performed better on average, they were not always better than employee-managers. Indeed, several franchisor informants, such as RealCo's Managing Director, made the point quite firmly that, just as there are poor performing employee-managers, there are also poor performing franchisees and, some employee-managers do perform better than franchisees.

The franchisor's assumption that owners perform more highly than employees played a

very important role in the choice between alternative franchising forms. Companies that operated forms that maximise owner-involvement in individual units (i.e., single-unit franchising and indirect multi-unit forms) adopted them mainly because they felt these forms provided unit-managers with improved motivation, through ownership, for them to operate diligently. More specifically, they provided unit-operators with residual claims tied to their unit's performance (Brickley & Dark, 1987; Combs & Ketchen, 1999; Rubin, 1978). Corresponding with that logic, those same firms rejected direct multi-unit forms, namely sequential franchising and area development did so, largely, on the basis those types of franchising involve a greater prevalence of employee-managers.

Incentives were also important at the chain management level. Companies that operated indirect multi-unit franchising forms (i.e., ServCo, FastCo and also SnackCo) instead of hiring employee regional managers did so, mainly, to provide such regional representatives with incentives that would motivate them to operate more diligently. ServCo, FastCo and SnackCo believed that owner-operating area representatives and/or subfranchisors would be motivated, because they were owners, and therefore risked their investment, to operate more diligently than salary-based regional managers.

Firms that adopted direct multi-unit forms placed less emphasis on the importance of incentives relative to other factors. At VideoCo, for example, incentives provided by owner-involvement were scarcely mentioned. At RealCo incentives were more important. Indeed, incentives were cited as an important reason for the initial decision to convert the company-owned chain to franchising. Further, while the current form compromised incentives by allowing franchisees multiple-units, franchisor informants were committed to increasing the prevalence of owner-involvement at the unit-level. Realising low average productivity and performance per multi-office unit, the franchisor was committed to reducing the size of such multi-office networks.

#### *Growth Aspirations*

A desire for growth was also reflected in some decisions pertaining to form. While all companies in this study desired expansion, some harboured more ambitious growth aspirations than others. Indeed, three of the seven companies studied wanted rapid unit growth. These were RealCo, ServCo and FastCo. Therefore, these companies adopted

franchising forms that might facilitate more rapid growth. Indeed, all adopted multi-unit forms that might facilitate more rapid growth than single-unit franchising. Further, these firms selected the most growth facilitating multi-unit forms. For example, within direct multi-unit forms, RealCo made use of area development, which facilitates greater growth than sequential franchising. Similarly, within indirect multi-unit forms, ServCo and FastCo operated subfranchising, which facilitates more rapid growth than area representation. The capacity for growth provided by these forms was important in decisions of these three companies. Indeed, for RealCo, the desire for achieving rapid growth appeared to override many other considerations pertaining to form, such as control.

#### *Need for Control*

While some companies adopted forms for their capacity to facilitate very rapid growth, others preferred those that preserved more control. Indeed, the choices made by a number of companies were influenced by their key decision-makers need for control. MortCo illustrated the important and pervasive role need for control could have in franchising decisions. MortCo preferred single-unit franchising because it enabled the franchisor to maintain a direct relationship with each unit-level consultant. MortCo was seriously tempted by indirect multi-unit franchising forms, such as area representation and subfranchising, due to frustrations with current levels of growth. MortCo ultimately, however, preferred single-unit franchising, mainly, because it provided a higher level of control. MortCo's analysis to determine the relative attractiveness of area representation and subfranchising was also influenced by a need for control. MortCo's founder initially found subfranchising more appealing than area representation, due to his desire to increase growth. However, his interest in subfranchising diminished after considerations pertaining to control. Indeed, MortCo preferred area representation to subfranchising because it preserved more direct franchisor control over unit-level consultants.

SnackCo's decision to adopt area representation over subfranchising was also influenced by the founder's need for control. The founder preferred area representation because it enables them to maintain more influence in unit-level operations.

Finally, a need for control also influenced VideoCo and RealCo's evaluations and choices pertaining to franchising form. VideoCo preferred (and operated) sequential franchising to

area development because it maintained greater franchisor control over unit-level development. RealCo decided recently to limit the ability of franchisees to operate additional units. Initially RealCo utilised sequential franchising and area development widely in order to facilitate very rapid unit-growth. However, the franchisor management team later realised that both forms, by allowing franchisees to operate multiple offices, compromise franchisor control of real estate offices.

VideoCo and RealCo's preference for direct over indirect multi-unit franchising forms was also motivated by a need for control. Key decision-makers in both companies foresaw control problems associated with indirect forms, such as area representation and subfranchising. They felt that delegating franchisor-related activities to master franchisees compromised control over unit-level operations to an unacceptable level. Interestingly, both companies felt that problems associated with control-loss were accentuated by the remuneration structure of indirect forms. VideoCo and RealCo franchisors felt that having income dependent on territory performance could motivate master franchisees to variously: maximise sales within their territories, adapt the system to their territory at the expense of system-wide uniformity, and provide low quality franchise recruitment, training and support.

### **Firm-Specific Factors**

Two factors pertaining more specifically to the firm also contributed to form choice. These are resource constraints and franchisee aspirations.

#### *Resource Constraints*

A lack of financial and/or managerial resources featured prominently in SportCo, RealCo, SnackCo, ServCo and FastCo's franchising decisions. All cited a shortage of financial capital as one reason for the initial decision to franchise operations. Because many franchisors possessed limited resources, that capital was important for expansion. Franchising produced more rapid unit-growth than was possible solely using company-owned development.

Access to capital was also important for firms requiring a network of regional representatives. Indeed, companies that adopted indirect forms (SnackCo, ServCo and

FastCo) noted they could not have afforded to establish a network of employee regional representatives using company money. Indirect forms obviated the franchisor investment that would otherwise be associated with establishing a network of salaried regional managers. Area representatives or subfranchisors provided both the financial and managerial resources to establish and manage regional management positions. FastCo exemplified the importance of resource constraints in their decision. The founder noted they would never have been able to achieve the growth they have experienced had they limited their expansion to company resources.

#### *Franchisee Aspirations*

Choice of franchising form was influenced by franchisee aspirations in three companies, namely SportCo, VideoCo and RealCo. All three companies had ambitious franchisees that wanted to expand their operations by purchasing and managing additional franchises. Those aspirations were important driver of multi-unit franchising for each of those companies.

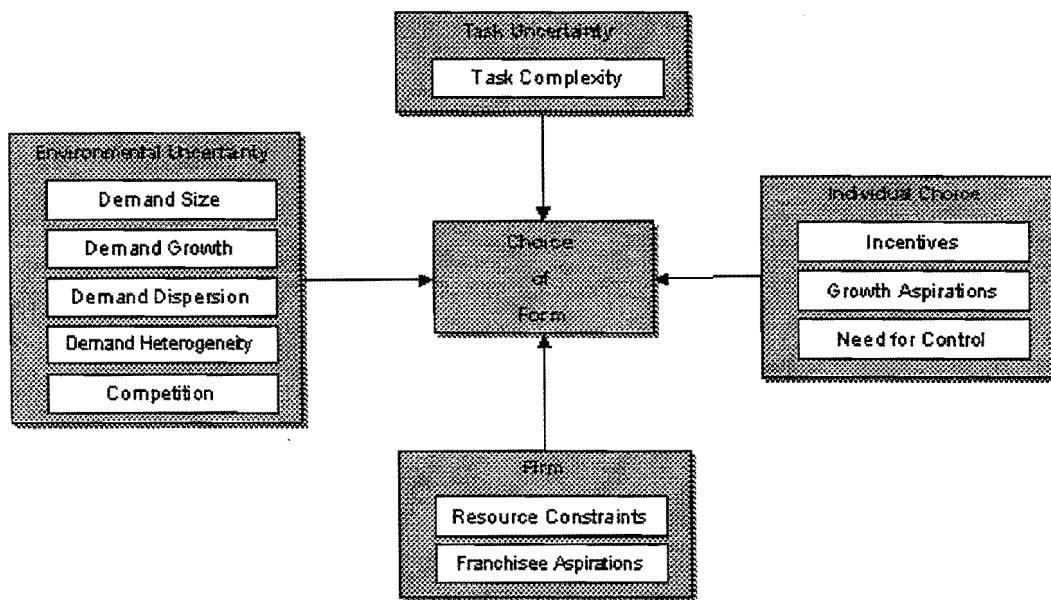
Of the three companies, RealCo's form decisions were influenced most markedly by franchisee aspirations. At RealCo, some franchisees were particularly desirous of expanding their personal network of offices. Importantly, the franchisor recognised that multi-office networks on average under-performed and wielded power that made chain management difficult. Despite that recognition, however, the franchisees possessed sufficient power, and exhibited such a threat of defection, that the franchisor was more inclined to let them expand than face losing them.

Manager ambition and concern relating to managerial retention contributed to two companies decisions to franchise – mirroring the influence of franchisee aspirations on choice of franchising type. Prior to franchising both RealCo and MortCo executives were frustrated with the loss of talented managers. Prior to franchising RealCo and MortCo had few opportunities for advancement to extend such talented and ambitious unit managers. That situation then contributed to both companies decision to franchise operations. Both MortCo and RealCo felt that business ownership, through franchising, could provide greater internal opportunities to help such managers realise higher personal and business objectives.

## MULTIPLE EXPLANATIONS

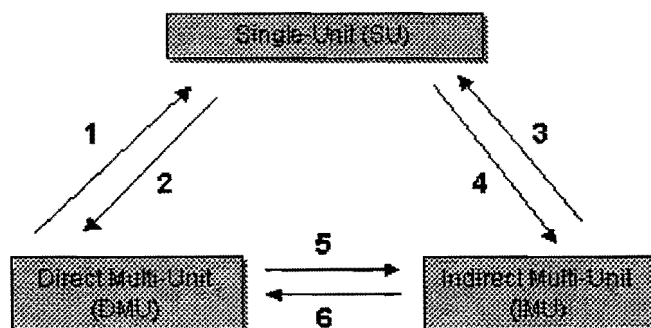
The findings illustrate that there were multiple factors influencing choice of franchising form. The analysis in the previous two sections of this chapter explored the influence on form choice of eleven separate factors representing environmental and task uncertainties, firm-level and individual choice (see Figure 3).

**Figure 3**  
**Determinants of Franchising Form Choice**



**Figure 4**  
**Franchising Form Preferences**

#	Preference
1	SU over DMU
2	DMU over SU
3	SU over IMU
4	IMU over SU
5	DMU over IMU
6	IMU over DMU



This section draws on both the preceding sections of this chapter, and individual case descriptions, to illustrate how these different factors influenced each of six possible preferences between the three primary categories of form (see Figure 4). This format reveals, more clearly, that no one factor explains form choice in its entirety. Instead, multiple factors operate, often in concert, to explain the different preferences and choices between franchising forms.

### **1. Single-Unit over Direct Multi-Unit Franchising**

Preferences for single-unit franchising over direct multi-unit franchising were influenced by factors at the environmental and individual level. At the environmental level, direct multi-unit franchising offered few benefits to companies operating in a small market. Where few units were required to be established, informants preferred to have owners operate units and maintain a direct relationship with each unit-manager. Single-unit franchising was also preferred where market growth was small or negative, and where competition was intense, because it involved owner-operators, who were regarded as more diligent and motivated than employee-managers. Informants also preferred single-unit franchising to direct multi-unit franchising, in a competitive environment, because it provided the franchisor with greater power relative to franchisees. Greater power enabled the franchisor to implement new initiatives and effectively monitor units. Comparatively, by allowing franchisees to add units, direct multi-unit franchising reduced franchisor power relative to franchisees.

Diverse customer requirements, and unit-management complexity also influenced the preference for single-unit franchising. Single-unit franchising was preferred where high levels of both factors existed. This was because single-unit franchising maintained owner-operators and a direct franchisor-franchisee relationship. Owner-operators were perceived as more responsive to diverse to customer requirements when demand was heterogeneous. Owner-operators were also regarded as advantageous where tasks associated with managing units were complex. That was because complex operations required very good decision-making, and owners were perceived as more diligent than employee-managers. An added advantage of having owner-operators was a low level of turnover compared to

employee-managers. Lower turnover meant operators were more experienced, generally, and therefore better able to successfully manage complex units. A direct franchisor-franchisee relationship was also preferred in heterogeneous and complex environments for two reasons. First, a direct relationship enabled efficient communication of important market information. Second, a direct relationship meant the franchisor maintained control over recruitment training and support; factors important in heterogeneous and complex environments.

The preference for single-unit franchising over direct multi-unit franchising was also influenced, at the individual level, by key decision-maker beliefs pertaining to incentives. Indeed, some franchisor executives felt strongly that owners made better unit managers than employees. Such franchisors variously felt owners were more motivated, diligent, productive, loyal and committed, and exhibited lower turnover. Those beliefs strongly influenced the preferences for single-unit franchising over direct multi-unit franchising. Key executives need for control also influenced preferences for single-unit franchising at the individual level. Executives exhibiting a desire for power over units preferred single-unit franchising because it involved the franchisor maintaining a direct relationship with operators of each and every unit. Single-unit franchising also allowed franchisors to maintain greater power over franchisees and, therefore, each unit, by limiting franchisees to a single unit.

## **2. Direct Multi-Unit over Single-Unit Franchising**

The preference for direct multi-unit franchising over single-unit franchising was influenced by six factors relating to the environment, firm and individual. Market size and growth, the growth aspirations of key decision makers, and resource constraints, influenced the preference for direct multi-unit franchising in a similar way. Direct multi-unit franchising was generally preferred where levels of each factor was high. Direct multi-unit franchising was preferred in these situations because it facilitated more rapid growth, by allowing existing franchisees to establish and operate additional outlets. Direct multi-unit franchising was also preferred where customers were highly dispersed. One company, in particular indicated that direct multi-unit franchising was advantageous in



areas remote from the franchisor because, by allowing remote franchisees to expand, it reduced costs otherwise associated with the franchisor recruiting and establishing new franchisees for each and every geographically isolated unit.

Finally, the preference for direct multi-unit franchising over single-unit franchising was also influenced by the growth aspirations of franchisees. Indeed, franchisees in companies adopting direct multi-unit franchising were highly desirous of, and in most cases allowed, additional units. In one system, the strength of franchisee desire for additional franchises was so great that some franchisees were prepared to leave the company if the franchisor did not grant them.

### **3. Single-Unit over Indirect Multi-Unit Franchising**

A range of factors also contributed to the preference of single-unit franchising over indirect multi-unit franchising. These imperatives related solely to environmental and task uncertainties. Market size, growth and dispersion, and competition, each influenced the preference for indirect multi-unit franchising in a similar way. Each factor was related, at least, in part, to system-wide costs. In most instances, indirect multi-unit franchising was considered neither advantageous and/or viable in markets where: 1) the market size was small, 2) few opportunities for sustained growth existed, 3) demand was relatively concentrated (i.e., not highly dispersed), and 4) competition was intense. In such instances it was generally felt that indirect multi-unit franchising added unduly to system-wide costs, by duplicating franchisor-related responsibilities in different markets. In relation to competition, informants perceiving single-unit franchising to provide more efficient communication also preferred that form. Companies perceived that the efficiency of communication would be reduced by introducing master franchisees between franchisor and operating units.

Single-unit franchising was also preferred over indirect multi-unit franchising in situations where demand was heterogeneous. Informants considering diverse customers felt indirect multi-unit franchising would make maintaining an appropriate balance of local adaptation

and system-wide uniformity more difficult. It was felt that indirect multi-unit franchising could, due to its remuneration structure, motivate master franchisees to over-adapt units within their territory. Moreover, master franchisees might disregard long-term objectives for their own short-term gain. Single-unit franchising was also preferred for another reason. One company, in particular, felt that heterogeneous environments required effective communication. Single-unit franchising was therefore preferred because it maintained a direct relationship between the franchisor and operational units.

Finally, the complexity associated with managing units also influenced preferences for single-unit franchising. Companies operating complex business formats wanted to ensure the quality of franchise recruitment, training and support. Single-unit franchising was preferred to indirect multi-unit franchising because it involved the franchisor performing each function centrally. It was felt that delegating such activities to indirect multi-unit franchising master franchisees could reduce the quality of these functions.

#### **4. Indirect Multi-Unit over Single-Unit Franchising**

The preference for indirect multi-unit franchising over single-unit franchising was influenced by seven factors. At the environmental level, market size influenced the preference for indirect multi-unit franchising over single-unit franchising. Where markets were considered very large, indirect multi-unit franchising was preferred for its capacity to establish and manage large numbers of units. Indirect multi-unit franchising was advantageous because it provided financial and managerial resources at the regional level that helped facilitate unit-level growth, and provide on-going management. Comparatively, where market size was large, single-unit franchising was regarded as too burdensome on franchisor resources. Indirect multi-unit franchising was also preferred where market growth rates were very large, due its capacity to facilitate very rapid growth. In a rapidly growing market, indirect multi-unit franchising was believed to be advantageous for two reasons. First, it helped facilitate rapid growth by providing financial and managerial resources at a regional level. Second, it provided regional managers (as area representatives and subfranchisors) that were motivated, due to the

indirect multi-unit franchising remuneration structure, to facilitate rapid growth in their territories. Competition influenced the preference for indirect multi-unit franchising similarly. Companies adopting indirect multi-unit franchising said high levels of competition motivated them to utilise forms that facilitated more rapid growth than competitors. Markets where demand was highly dispersed also influenced preferences for indirect multi-unit franchising. Companies felt the costs associated with operating single-unit franchising, which involved centralising franchisor management, would be prohibitive where demand was very highly dispersed. Indirect multi-unit franchising was advantageous because it not only involved less cost, but also provided regional managers (as master franchisees) with better incentives than salary-based managers, due to its remuneration structure.

Incentives influenced preferences for indirect multi-unit franchising at the individual level. Key decision-makers felt that, where franchisor-related management was required at the regional level, indirect multi-unit franchising provided regional managers with better incentives than single-unit franchising. Under indirect multi-unit franchising, regional managers, as area representatives or subfranchisors, invest in their position and are rewarded based on the performance of their territories. By comparison, single-unit franchising provides salaried regional managers paid for by the franchisor. Companies that preferred indirect multi-unit franchising believed that the indirect multi-unit franchising remuneration structure provided regional managers, as master franchisees, with better incentives to work diligently with unit-operators to promote growth, and maximise performance, than salaried regional managers paid for by the franchisor. Growth aspirations also influenced the preference for indirect multi-unit franchising at the individual level. Key decision-makers with a desire for very rapid growth preferred indirect multi-unit franchising for its capacity to facilitate more rapid growth than single-unit franchising.

Finally, firm-level resource constraints also influenced the preference for indirect multi-unit franchising. Companies preferring indirect multi-unit franchising lacked the resources to institute a network of employee-based regional managers and support facilities that would otherwise be required with single-unit franchising. Compared to single-unit franchising, indirect multi-unit franchising enabled such companies to overcome financial

and managerial limits to growth at the regional management level.

## **5. Direct Multi-Unit over Indirect Multi-Unit Franchising**

The preference for direct multi-unit franchising over indirect multi-unit franchising was influenced by environment and task-related factors, and factors pertaining to individual choice. Environmental and task-related factors included market size, dispersion and heterogeneity, and managerial complexity. Direct multi-unit franchising was preferred in instances where market size and customer dispersion were both considered insufficient for indirect multi-unit franchising to be advantageous and/or viable. Direct multi-unit franchising was also preferred where demand was relatively heterogeneous. Such heterogeneous environments highlighted challenges associated with balancing appropriate levels of standardisation with local adaptation. Direct multi-unit franchising reduced the challenges associated with this task by maintaining a direct franchisor-franchisee relationship. By contrast, indirect multi-unit franchising, due to its remunerative structure, could compound these challenges. The complexity of unit management also contributed to preferences for direct multi-unit franchising. Direct multi-unit franchising was preferred where units were complex to operate because, by centralising rather than delegating franchisor-related activities, it was considered to provide higher quality unit-level recruitment, training and support.

Individual level factors, including incentives and a need for control, also contributed to preferences for direct multi-unit franchising. In relation to incentives, some informants preferring direct multi-unit franchising felt that indirect multi-unit franchising misaligned incentives within the franchise system. Specifically, they felt that because area representative and subfranchisor remuneration is based on the performance of their territories, such master franchisees would be inclined to possess a myopic focus on individual territory performance, and, variously, fail to implement and adhere to initiatives intended for the benefit of the system. Furthermore, indirect multi-unit franchising was perceived not to ensure the quality of franchise recruitment, training and support. Direct multi-unit franchising, by comparison, did ensure quality in each of these areas, by both centralising franchisor-related activities, and maintaining a direct franchisor-franchisee

relationship.

The final individual-level factor, namely a need for control, contributed to the preference for direct multi-unit franchising in a similar way. Direct multi-unit franchising was preferred by those wanting to both maintain a direct franchisor-franchisee relationship, and direct control of franchisor-related activities. Informants preferring direct multi-unit franchising believed those two structural attributes helped ensure the quality of franchisor-related activities, and reduced problems otherwise associated (if utilising indirect multi-unit franchising) with system-wide adaptation, recruitment, training and support.

## **6. Indirect Multi-Unit over Direct Multi-Unit Franchising**

Preferences for indirect multi-unit franchising over direct multi-unit franchising were influenced by four factors relating to the environment and individual choice. Informants considering markets that were very large in size, featured potential for high and sustained growth, and/or were highly dispersed, preferred indirect multi-unit franchising. Indirect franchising was preferred in these instances for its capacity to facilitate and manage rapid, and large-scale, unit-growth, at minimal cost to the franchisor. Indirect multi-unit franchising reduced franchisor costs, otherwise associated with growing and managing a large and dispersed network of operators, by recruiting master franchisees who invested, in order to operate, in regional management and support positions. Indirect multi-unit franchising was also preferred due to its remunerative structure. Key executives, favouring indirect multi-unit franchising's remunerative structure, believed the form provided operators at both the regional management and unit-level with unrivalled motivation and incentives to perform diligently. Such operators were perceived to perform more diligently because 1) they invested in their roles, and 2) their income was tied more directly to their performance.

## **CHAPTER 7**

### **CONCLUSION**

#### **Introduction**

This chapter begins by summarising the most significant findings. The influence of environmental and task uncertainties, along with additional factors found to be important, on choice of franchising form, are recounted. I then discuss the implications of these findings for franchising research, organisation theory and franchising practitioners. The chapter concludes with suggestions for future research.

#### **Key Findings**

Using a case study research methodology, involving interviews, documentation and direct observations, this research addressed two primary research questions: 1) do environmental and task uncertainties influence choice of franchising forms, and 2) what other important factors influence choice of franchising forms? Answering these questions, my findings show support for the thesis that environmental and task uncertainties do influence the selection of franchising forms. Certainly, in as far as the types of franchising utilised by most companies were consistent with my propositions for the majority of factors, my findings suggest that environmental and task uncertainties do influence choice of franchising form. Importantly however, as I discuss below, the overall fit is not neat and conclusive. Indeed, the findings illustrate some situations where factors had a less than anticipated effect on franchising form choice and other situations where form choice occurred contrary to expectations. The research also produced other important findings. These include five further factors, relating more specifically to individual choice and the firm, found to also influence franchisor's choice of franchising forms.

#### **Environmental and Task Uncertainties**

My findings illustrate general support for the thesis that environmental and task

uncertainties influence the choice of franchising form. More specifically, this investigation found that environmental munificence, complexity and dynamism, and task uncertainty were useful concepts for helping understand and explain the utilisation of single-unit franchising, direct multi-unit franchising and indirect multi-unit franchising. The following factors were chosen and operationalised to represent each concept: demand size and growth (environmental munificence), demand dispersion and heterogeneity (environmental complexity), intensity of rivalry (environmental dynamism) and task complexity (task uncertainty). Support for these factors was evidenced in as far as the forms utilised by companies were consistent with my propositions in the majority of cases. Indeed, 35 out of 42 possible company form-factor combinations (i.e., 6 factors \* 7 firms) were at least consistent with expectations derived from the model.

While there was general support for my propositions, and therefore the model, however, the explanatory power of individual factors varied. Certain factors were more important in franchisor decisions than others. That level of importance was evident in the logic underlying form choice. Indeed, the logic was more explicit and observable for some factors than others. The explanatory power of the factors, and the dimensions of environmental and task uncertainties they represent, are discussed next.

The concept of environmental munificence influenced franchising form choice as expected. Market size and growth of demand were important considerations in most franchisor decisions. Demand size, in particular, was very important and the logic underlying my proposition for this factor was observable in most companies' decisions. Franchisors considered the size of demand in their decisions. When demand size was small, franchisors selected single-unit franchising, which maximises owner-involvement in individual units and, through a direct relationship with franchisees, preserves franchisor bargaining power and scale economies. Conversely, when demand size was large, franchisors were prepared to trade these benefits in order to facilitate the establishment and management of a greater number of units.

Market growth also influenced choice of franchising form. Most companies were in fit and some explicitly followed the logic of my propositions. Indeed, in an environment featuring rapid growth in demand, companies felt constrained by single-unit franchising and chose

multi-unit forms to expand their chains more rapidly. I also found indirect support for my proposition from one of two companies that did not adopt the expected type of franchising. RealCo adopted a form contrary to predictions, but experienced problems and challenges consistent with an *environmental factor - franchising type* mismatch. In alignment with my model, those experiences contributed to RealCo's decision to re-evaluate their franchising type.

I was also able to gain insight into the relative importance of demand size and growth. Evidence from one company (MortCo) illustrated how the influence of demand size can over-ride the influence of demand growth. MortCo operated in a market that grew very rapidly but was limited, ultimately, in size. In a growing market, MortCo found the capacity of indirect multi-unit franchising capacity to facilitate and manage company growth to be very compelling. MortCo's view was tempered greatly, however, by consideration given to the potential for total units. For MortCo, like many other companies in this investigation, that potential for total units was considered too small for indirect multi-unit forms, such as, area representation and subfranchising, to be viable. Logic suggests two circumstances where viability problems are most likely to occur. The first is in small markets, like New Zealand, with small populations. The second is in franchise systems with highly specialised product/service that, by their nature, require large populations to support individual units. Both circumstances limit the potential number of units that can be sustained.

Environmental complexity, comprising demand dispersion and heterogeneity, also influenced franchising form choice. The geographic dispersion of demand impacted on franchisor decisions. When demand was highly dispersed franchisors adopted multi-unit over single-unit franchising to minimise recruitment and on-going management costs. In contrast, single-unit franchising was selected for systems when demand was less dispersed. That helped suggest the tasks associated with recruitment and management were less consequential for systems with less dispersed demand. The findings also suggest that demand dispersion has explanatory power over and above that provided by demand size and growth. ServCo illustrated that power. ServCo's founder stated that ServCo would seriously consider adopting single-unit franchising, instead of subfranchising, if their more than 550 units were located closer to franchisor headquarters. In an additional



area, demand dispersion also helped explain the choice between direct and indirect multi-unit forms. The evidence suggested that indirect (versus direct) multi-unit forms were associated with highly dispersed (versus concentrated) demand.

Demand heterogeneity also influenced form choice in some situations. The evidence suggested form choice was influenced most in situations where demand was heterogeneous rather than homogeneous. Indeed, franchisors operating in an environment where customer requirements varied widely related these circumstances to the difficult tasks of balancing local responsiveness with standardisation. Those tasks, in turn, necessitated having diligent unit management, franchisor control and bargaining power, which were more readily achievable with high levels of owner-involvement and a direct relationship with franchisees. Consequently, the single-unit form was preferred when demand heterogeneity was high. In contrast, companies operating in an environment featuring relatively homogeneous demand relaxed the preference for single-unit franchising. Finally, evidence from one company (RealCo) helped explain the choice between direct and indirect multi-unit forms. RealCo suggested that direct forms might be preferred over indirect forms when demand is heterogeneous because the franchisor maintains more direct influence over unit-level operations.

Intensity of rivalry - selected to represent the third and final environmental dimension, environmental dynamism - had a less than expected influence on franchising form choice. Indeed, less than half of the companies investigated provided support for my proposition by adopting the expected type of franchising form. Yet while many form-factor misfits were apparent, according to my model, support existed for aspects of the logic underlying the proposition. In particular, all except one company felt that providing operators with motivational incentives was critically important when operating in an intensely competitive environment. Furthermore, one or more firms propounded the importance of other arguments - such as, maintaining direct relationship, in order to provide efficient co-ordination between units for purchasing, and bargaining power, for the implementation of important initiatives - to decisions pertaining to organisational form choice, in a competitive environment. Two companies operating types of franchising contrary to predictions were also informative. Indeed, the utilisation of subfranchising by ServCo and FastCo, in intensely competitive environments, illustrated how no one factor, in isolation,

determined choices made between alternative types of franchising. Instead, these exceptions suggested that other factors could influence the importance of individual arguments that make up the logic underlying each proposition. For example, in a competitive environment, we expected that indirect multi-unit franchising forms would be inefficient in terms of costs, because it involved duplicating franchisor-related activities in different markets. Yet, for other factors, such as market size, growth and dispersion, both companies felt that duplication was necessary.

The influence of the final factor, task complexity (representing task uncertainty), on form choice supported my proposition. The explanatory power of this variable was strong and all form-factor combinations were in fit with predictions. Furthermore, the influence of task complexity was noted by business formats featuring both very complex and simple task uncertainty. Corresponding with expectations, informants from cases featuring greater managerial complexity placed greater emphasis on form characteristics that engender quality recruitment, good unit-management decision-making, and quality training, support and monitoring. Accordingly, the most complex business formats utilised single-unit franchising in order to provide these characteristics. In contrast, the research suggested that companies operating in environments featuring relatively simple business formats were less constrained in their selection. For example, the franchisors of companies utilising subfranchising stated explicitly that they were able to operate that type of franchising because their business formats were so simple. It meant tasks associated with activities such as unit-management recruitment, training, support and monitoring were more easily specified and, therefore, amenable for delegation to master franchisees.

### **Individual and Firm-Specific Factors**

Other important factors were found that also influenced the choice of franchising form. These findings illustrate the strength of the qualitative methodology employed. Indeed, five further important factors that influenced franchising form choice were uncovered during the research. These factors consisted of variables relating to individual choice and the firm.

Three factors, including incentives, franchisor growth aspirations and the need for

franchisor control, related to individual choice. Individual choice played an important role in franchising decisions. My findings demonstrated that the founders and/or key personnel harboured different aspirations, beliefs and preferences. Such differences, in turn, influenced form decisions in myriad ways.

Many decisions to franchise operations were influenced strongly by key decision-makers beliefs pertaining to motivation and incentives. Indeed, company founders and key decision-makers often believed that franchise owners (or franchisees) invariably made more motivated and diligent managers of units than employees. The logic underlying that belief corresponded closely with the concept of moral hazard in agency theory (e.g., Fama and Jensen, 1983). Following that theory, employee-managers were likely to exert less effort and consideration in managing units than franchisees because they did not bear the full costs associated with their behaviour (Brickley & Dark, 1987; Combs & Ketchen, 1999; Rubin, 1978). By contrast, owner-operating franchisees were residual claimants on the proceeds of the units they manage; thereby increasing the likelihood they will manage their units diligently (Brickley & Dark, 1987; Rubin, 1978). This belief influenced founders and/or key decision-makers original decision to franchise, as most were experienced and frustrated by the poor management of company-owned operations.

Decision-makers perceptions of incentives also influenced the type of franchising chosen. Companies, whose key decision-makers clearly believed in the importance of providing unit managers with appropriate incentives adopted forms, such as single-unit franchising, area representation and subfranchising, which maximised owner-involvement at the unit-level. Key decision-makers considerations of incentives also influenced choice of franchising type at the regional level. Indeed, companies that adopted indirect multi-unit franchising forms, such as area representation and subfranchising, were clearly influenced by their key decision-maker's considerations of incentives. These decision-makers preferred area representation or subfranchising because they made regional managers (as area representatives or subfranchisors) residual claimants on the performance of their territories. The decision-makers therefore felt area representatives and subfranchisors would be more motivated to perform diligently than employee-based regional managers paid for by the franchisor.

The growth aspirations of key decision-makers also strongly influenced the type of franchising selected. Indeed, some sought very rapid unit-growth and favoured forms such as, area development and subfranchising because of their capacity to achieve growth. In contrast, the growth aspirations of other companies were tempered by the founder's or other key decision maker's desire or need for control. Indeed, while some wanted to build system size they also demanded power and control over unit-level operations. Single-unit franchising was preferred for maximum control. In other instances, key executives selected area representation over subfranchising and sequential franchising over area development because they felt these types of franchising preserved more appropriate levels of franchisor control.

This research also identified two firm-specific factors that influenced form choices. These include resource constraints and franchisee aspirations. The first, resource constraints, referred to financial as well as managerial resources and closely resembled the original concept of resource scarcity proposed by Oxenfeldt and Kelly in 1969. Oxenfeldt and Kelly (1969) proposed that franchising was useful for procuring much required financial capital, skilled management and knowledge of local conditions to chains, particularly during their establishment period. My findings showed that most companies cited access to financial capital as an imperative for franchising, but some also highlighted the importance of accessing managerial resources.

The concept of resource constraints also influenced choices made between different types of franchising. The companies utilising subfranchising clearly illustrated that influence. The founders of both companies desired rapid and massive growth but had neither the financial or managerial resources to establish and manage a network of nationwide regional managers and/or unit-level operators. Subfranchising enabled both companies to overcome resource-based constraints to growth.

Franchisee aspirations, the final factor, also influenced choice between different types of franchising. Decisions in two companies were influenced by ambitious franchisees that wanted additional franchises. The influence of franchisee aspirations drew these franchisors toward direct multi-unit franchising. In one system the ambition was coupled with a credible threat of defection and contributed very strongly to decisions allowing

franchisees to accumulate multiple units.

### **Implications for Theory**

A number of important findings were uncovered during the course of the research that contribute to franchising research and organisation theory. I examine these in turn before considering the practical implications of this research.

#### ***Franchising Research***

This work adds to existing franchising research in at least five ways. First, it contributes substantially to an explanation of why different types of franchising exist. Other researchers and writers have examined the relative advantages/disadvantages, and growth, management and survival issues associated with selected franchising types (e.g., Bradach, 1995, 1997, 1998; Dant & Gundlach, 1998; Dant & Nasr, 1998; Justis & Judd, 1986; Kaufmann, 1992; Kaufmann & Dant, 1996, 1998; Kaufmann & Kim, 1995; Lowell, 1991). My research extends that understanding further by not only considering the influence of factors related to environmental and task uncertainties, but also uncovering several additional factors found to contribute to decisions pertaining to franchising form. Additionally, my research contributes considerably by involving a more comprehensive set of franchising types.

Second, this research adds to previous efforts by introducing a new theoretical perspective to the analysis of alternative forms. Previous research has analysed selected forms in view of agency theory (e.g., Kaufmann, 1992; Kaufmann & Dant, 1996; Kaufmann & Kim, 1995) and resource constraints (such as, capital acquisition)(e.g., Kaufmann & Dant, 1996). This research is unique in that it integrates and applies concepts from structural contingency theory, agency theory and transaction cost theory, to show how environmental and task uncertainties can and do influence franchising form choice.

Third, this research increases our general understanding of different types of franchising arrangements, answering calls from a number of researchers (e.g., Bradach, 1995, 1997, 1998; Dant & Gundlach, 1998; Dant & Nasr, 1998; Kaufmann, 1992; Kaufmann & Dant, 1996, 1998; Kaufmann & Kim, 1995) to move beyond the outdated and erroneous

conceptualisation of franchising whereby franchisees are implicitly or explicitly assumed to: 1) own and operate individual units and, 2) contract directly to the franchisor. This is especially important given that multi-unit forms are pervasive and single-unit franchising might actually be an exception rather than the norm (Kaufmann & Dant, 1996, 1998). Further, that the differences between alternative franchising forms can give rise to such varied and important operational implications means that this simplistic characterisation is inherently problematic.

This research demonstrates the complexity of franchising form choices and franchise system organisation. It illustrates how multiple forms may operate simultaneously within a single franchise system, and also shows how decisions pertaining to form may change over time due to a variety of factors, such as franchisor experience and stage of company or franchise development. The research also calls into question the very definitions of franchising forms. For example, the research shows how difficult it is to find pure examples of certain franchise forms in franchise organisations. This insight calls into question whether current theoretical definitions of franchising forms are, in fact, an oversimplification of practice. This research also adds potential new forms, such as the Franchise Partnership Structure identified in SportCo, to our existing range of franchising definitions.

Fourth, my research confirms that multiple perspectives are necessary to understand franchisor decisions pertaining to franchising form (Combs & Ketchen, 1999; Kaufmann & Dant, 1996; Shane & Foo, 1999). Indeed no one theory or factor was sufficient to explain the complex choices franchisors made between different types of franchising. Instead, a number of theories and factors were complementary and in some cases interacted, to offer a more complete understanding of franchising form choice.

Fifth and finally, this research adds to the limited number of qualitative accounts that exist on franchising (e.g., Bradach, 1995, 1997; Floyd & Fenwick, 1999). Such qualitative accounts contribute to our knowledge franchising in a number of ways. They enable the investigation to retain the holistic and meaningful characteristics of real-life events (Yin, 1994, p.3) by focusing on understanding the dynamics present within single settings (Eisenhardt, 1989a, p.534). They also allow for contextual conditions that may be highly

pertinent to the phenomenon under study (Bryman, 1989; Eisenhardt, 1989a; Stake, 1994; Yin, 1994). Furthermore, as noted by Bryman (1989), the closeness to detail and familiarity with ongoing organisations provided by qualitative research can often prove more attractive to practicing managers, than the abstract variables characterised by much quantitative research.

### *Organisation Theory*

My research contributes to extant organisation theory in at least three ways. First, it integrates franchising with extant theory by adopting a structural contingency perspective to show how organisational design criteria are shaped by specific environmental and task contexts. Second, it extends structural contingency theory by unpacking the notion of fit in terms of transaction costs. I show how each design criterion and the environmental or task contingency that influences it, is associated with *ex ante* and *ex post* transaction costs. I argue and find that organisational forms that reduce transaction costs within specific environmental and task contexts will be in fit with these environmental and task contingencies. Third, my research contributes to integrating transaction cost economics with extant organisation theory. There has been a long-standing debate regarding the proliferation of perspectives within organisation theory (Donaldson, 1995; Pfeffer, 1993, 1997; Van Maanen, 1995a, 1995b). This debate has been accompanied by a concern over the dominance of economic theories of organisation such as transaction cost economics and agency theory (Donaldson, 1990; Pfeffer, 1993). Both transaction cost economics and agency theory have been criticised on several counts. Transaction cost theory has been particularly criticised for lacking realism and balance in its analysis of organisational forms (Ghoshal & Moran, 1996; Moran & Ghoshal, 1996). I concur with this criticism and propose that transaction costs exist within a broader environmental context (Granovetter, 1985). In this research, I view transaction costs as being embedded in specific environmental and task contexts and operationalise these costs in terms of *ex ante* and *ex post* costs. Thus, the research sought to illuminate how transaction cost contingencies shape organisational forms.

## **Implications for Practice**

On a practical level, this research helps franchisors choose between alternative organisational designs in specific environmental or task contexts. It helps franchisors move beyond assessing the relative advantages and disadvantages of different forms by specifying a range of contextual considerations and showing how different levels of each can affect the suitability of each form. I believe that the findings are particularly relevant for franchisors seeking to enter or expand into emerging economies. With the gradual saturation of the U.S. market, most growth for existing franchisors is likely to occur through international expansion. This paper offers a framework to make new and appropriate choices about franchising forms in new and/or small markets.

## **Future Research**

While the historic view of franchising, as characterised by single-unit franchising, has been a useful abstraction for much historical theorising and research (Kaufmann and Kim, 1995), the proven array and pervasiveness of alternative multi-unit forms (Grünhagen & Mittelstaedt, 2000) means franchise researchers must develop both models and research programs which more closely reflect that diversity.

Empirically testing whether the findings reported here apply to other franchise systems, expanding domestically, is a logical extension for this research. Countries with larger population and demand bases, like Australia, the U.K the U.S, would provide important comparisons for this research. Similarly, an opportunity exists to explore whether a similar range of factors influence the forms utilised by franchisors when entering foreign markets.

More fundamentally, this research highlights a lack of salient basic information detailing the range and incidence of alternative franchising forms. To date, researchers have focused on the U.S. fast-food sector and typically confined their analyses to a narrow range of forms (e.g., Kaufmann and Dant; Kaufmann and Kim, 1995; Robicheaux, Dant & Kaufmann, 1994). Consequently, fertile ground exists to investigate the incidence of all franchising forms across both business sectors and countries. Relatedly, this research also suggests that the range of franchising form definitions should be considered, and that



further studies should allow for the possibility of new forms, such as the Franchise Partnership Structure, identified in SportCo.

Addressing these issues is critical for researchers and practitioners to understand the full complexity of franchising, as it exists today. Furthermore, as this research demonstrates, an improved understanding can be critical to improving franchise system performance.

## **APPENDIX ONE**

### **Example Franchisor Interview Guide**

#### **Informant Background**

- Tell me about your background in the company.

#### **Company Background**

- Tell me about the development of the company
- How is the franchisor structured?
- What services do you provide to franchisees?

#### **Establishing Case Form**

- What type of franchising do you use?
- How did this develop?
- Why do you use this type of franchising?
- If you were to franchise again, would you use the same type of franchising?
- Would any of the other types of franchising be suited/not suited to your type of business? Why?

#### **Environmental and Task Related Factors**

##### **Demand Size**

- How do you define the market for your products/services?
- What is the size of the market for your products/services?
- Has the size influenced the type of franchising that you have used? If so, how?
- If the size of your market was larger/smaller would that have influenced the type of franchising you have used? If so, how?

##### **Demand Growth**

- Tell me about the demand for your products/services. Has it grown/been stable/declined?

- Has the \_\_\_\_ in demand influenced the type of franchising that you have used? If so, how?
- If the \_\_\_\_ in demand for your products/services was larger/smaller would that have influenced the type of franchising you have used? If so, how?

### **Demand Heterogeneity**

- Tell me about the needs and tastes of your customers. Are they similar or varied? Do they differ? If so, how?
- Did the level of similarity/diversity of customer requirements influence the type of franchising you have used? If so, how?
- If customer requirements were more similar/diverse, would this have changed the type of franchising that you have used? If so, how?

### **Demand Dispersion**

- Where are your customers and units located?
- Did the spread of customers and units influence the type of franchising you have used? If so, how?
- If customers and units were more/less dispersed, would this have changed the type of franchising that you have used? If so, how?

### **Competition**

- Tell me about your competition. How many do you have? Are they large or small, strong or weak? How intense is competition?
- Did the level of competition influence the type of franchising that you have used? If so, how?
- If the level of competition were more/less intense would that have changed the type of franchising that you have used? If so, how?

### **Managerial Complexity**

- Please describe the range of products/services you offer to your customers.
- How difficult is it for a unit manager to prepare the product/service for sale to your customers?

- Tell me about your suppliers? How many? Do unit managers deal directly with suppliers?
- What separate inputs do unit managers need in order to prepare the product or service for sale to customers?
- Overall, how complex are individual units to manage?
- Did that level of managerial complexity influence the type of franchising that you have used? If so, how?
- If individual units were more or less complex to manage, would that have changed the type of franchising that you have used? If so, how?

## **APPENDIX TWO**

### **Example Franchisee Interview Guide**

#### **Informant Background**

- Please tell me about your background, and how you came to be involved with \_\_\_\_\_.

#### **Establishing Franchisee Form**

- Please tell me about your franchise.
  - Do you have an exclusive territory?
  - Do you have more than one franchise? If so, how did that happen?
  - Are you allowed more than one franchise?
  - What rights and responsibilities do you have as a franchisee?

#### **Environmental and Task Related Factors**

##### **Demand Size**

- N/A

##### **Demand Growth**

- Tell me about the demand for your products/services. Has it grown/been stable/declined?
- Has that \_\_\_\_\_ in demand affected your business operations? If so, how?

##### **Demand Dispersion**

- N/A

##### **Demand Heterogeneity**

- Tell me about the needs and tastes of your customers. Are they similar or varied? Do they differ? If so, how?
- How does that similarity/diversity in customer requirements affect your business

operations?

### **Competition**

- Tell me about competitors in your area. How many do you have? Are they large or small, strong or weak? How intense is competition?
- How does that level of competition affect your business?

### **Managerial Complexity**

- Please describe the range of products/services you offer to your customers.
- How difficult is for you to prepare the product/service for sale to your customers?
- Tell me about your suppliers? How many? Do you deal directly with suppliers?
- What separate inputs do you need in order to prepare the product or service for sale to customers?
- Overall, how complex is your unit to manage?

## **APPENDIX THREE**

### **Example Franchisor Transcript: A Snapshot**

#### **Interviewer**

So once you had made the decision to franchise, did you make the move...

#### **Interviewee**

...to totally franchised operators. There was and has been... well why did we franchise Christchurch? Christchurch is our successful operation. Why didn't we continue? But if you look at the business and the objectives of the business one of the crucial problems that we are facing was that we had the only people that were guaranteed income were the consultants. In other words they were absolutely guaranteed their margin and their overheads were covered by the company. So in other words they were in a control situation where the controls of the organisation were at the wrong end. You know they weren't employees and we didn't want to have an employ scenario and that is why it was developed. It was stepped up we passed on... the objective of franchising is we pass on all the costs. In other words the only person who is guaranteed their section of the income is us and how we manage our overheads is...

#### **Interviewer**

... you are still sharing it though really aren't you?

#### **Interviewee**

Yeah to a certain extent but the bulk of the risk is now with the franchisees as in if they don't get up in the morning then they don't generate income but their costs of operating the business are still incurred including the cost of an office and other costs they have had to incur themselves. If they don't generate income they are not incurring costs on us as such. They just avoid so it is a cost they cannot avoid.

#### **Interviewer**

For sure, so there is a different feeling of productivity from when the mortgage consultants were 100% commission? But there is still quite a difference between being a franchisee

and a...

**Interviewee**

...yeah well franchising and this is where the control side of it comes in. That is why the structure is set up the way it is because we need to maintain absolute control in other words, if we just gave the franchisee the rights to well here's the rights to a brand name go out and use it then we could very quickly lose control. And again why we haven't franchised general areas to operators is because then we are reliant on those operators without being able to control what they do. So that is why we put in a franchise where we are more heavily involved in the controls side of operating the business.

**Interviewer**

So if we look at the different types of franchising. This one here (pointing to illustration) is essentially what you have got. You tell me if I am wrong, but you are the franchisor and you have got franchisees that have only got the rights to one business and can only have one themselves.

**Interviewee**

Yes that's it

**Interviewer**

Now if you were to do it again would you do it the same way?

**Interviewee**

Well basically it was developed that way it was more it was more... the reason we franchised as such was we wanted to attract a different type of individual. We wanted to attract somebody who was an independent business thinker. In other words not just somebody who just wanders in 9 till 5 but somebody who wanted their own business but needed the safety net. So I was we don't want the true entrepreneurial type but we want somebody who wants ownership to feel in charge therefore be motivated to work. We don't want the entrepreneur because they will move in too many different directions and we'll lose the focus of the business. So I'd say we probably stick with the same structure because it would again attract the individual that we wanted... and that I think we are



pretty much getting what we want in the way of the individuals and being able to deliver that as well. So yeah.

**Interviewer**

Great. So if we move on to the next one then in this (pointing to illustration of sequential franchising) type of scenario the franchisees, if they are high performer, would be allowed to buy a second franchise, which they would have a manager which they would employ running [the second business], would you...

**Interviewee**

...well the structure of what we have allows us that. A franchise can be owned by an individual. They could be a company. That can be an individual. If they are a company there are restraints on that company. So in other words yes we have the opportunity for a franchisee to actually sell his own franchise to a company and take on another franchise through that company and employ someone basically.

**Interviewer**

So they could potentially have one and then have another, basically?

**Interviewee**

But there are two issues here. What makes a good franchisee and what makes a good franchisor. Because we would be allowing them to become a franchisor or virtually what you would call a subby or a franchisor imitating what we are doing. So therefore it is a case of we don't want to get into a case of the only way of expanding your possibilities is to move into a pseudo management position. It is like in the hospitals they discovered that doctors don't make the best managers but managers don't understand the medical environment enough. So you have got a situation of you need an administrator or you need a consultant and so we are saying well your role will always be consultant and you'll be writing mortgages till the day you die basically. But there is the structure. There is always the possibility of developing something according to the individual.

**Interviewer**

For example, I know in Whangarei you have...

**Interviewee**

Name, Name & Name who own the franchise and basically employ somebody in that position which works well. It does work well. I mean who is to say that the individual concerned doesn't leave. He has the same restrictions as a franchisee. In other words he has entered into that contract and understands that he has exactly the same restrictions. In other words he can't dump out and burn the owners of the business because if he chooses to enter a franchise or working for that franchisee he has also quite literally chosen to consider that if he is going to write mortgages he can only ever write mortgages for that company. He can't step away and create his own business. The restraint of trade is very strict and some have suggested is draconian, but it has to be for the protection of the business.

**Interviewer**

Well it protects the people joining and it protects you and...

**Interviewee**

... it also protects the people that they may sell their franchise to the others who are associated to it because they are buying rights to use to operate a very strong brand name and once they have developed their network they can't just change the brand name. So what we are saying is that if they choose to develop under the umbrella of that network then you know it is draconian but it is there for a reason. So personally I'm imagining that in two or three years time we are going to have an issue with one or two. You can tell by some of the legal questions prior exactly which individuals are looking at a future outside the organisation. But I believe we have got very strong grounds to say well hey look put it in the context of what they have purchased. They were aware of draconian nature of the your honour why are they wanting to leave the company and become a mortgage broker elsewhere? Because it is the skills they have learnt with this organisation that they are trying to...

**Interviewer**

Okay, so this system here (pointing to the illustration): If franchisees are successful they are allowed the rights to purchase another franchise. So this is on an incremental basis. So

if you did well with this one then we will let you have another. This one here is area development and I don't know if you have come across that...

**Interviewee**

...and again if you look at the structure of what we have done the structure of what we are trying to do the purest structure is individuals. But there are geographic issues where in New Zealand. You take 80% of the market is in the three major centres so they will never change to be any different than what they are or if it is restructured it will be on we will have an area manager who will basically take a margin and we will subcontract the franchisor's role to somebody as opposed to franchisees right. We will more change the structure of the franchisor. So in other words it won't directly impact the rights or operations of the franchisees. If one of the franchisees is to become that individual then yeah. But you take that into the smaller geographical areas like Hawkes Bay or for arguments sake our Tauranga operation. Tauranga is very loosely structured. There is a franchise that has been sold in there under a special agreement. The special agreement is they have rights to purchase the next franchise operation but it can also be and it depends on how they develop the business because it is owned by a husband and wife.

**Interviewer**

Okay, so there is two people operating?

**Interviewee**

Yeah it is one franchise. One of them is operating as the franchisee the other is potentially the second franchisee. But we are taking this on a developmental basis. In other words how we physically structure any future arrangement is yet to be determined on the basis of what we will require. But the objective at this stage is that hey that is an area we don't want to have too hands on a role in that area so they have you know taken Tauranga with extra rights I suppose or extra possibilities of having more of an area development because you take the franchisor's income from an area like Tauranga and then the costs of servicing that as a franchisor we are better off to pass on the management of that to the operator in the area.

**Interviewer**

Now this one here (pointing at an illustration of area development) that would mean... Now you can consider this by region, or even country, but consider say the Christchurch area. You would be giving a franchisee (or area developer) the rights to the area. They would obviously pay for it and they would establish franchises themselves who would be managers operating these. These aren't owner operators. So you would give them the rights to establish a whole area basically, with employee managers in place. This one here...

**Interviewee**

...is maintaining a franchisee operations becomes the area representative

**Interviewer**

Now the area representative attracts franchisees in an area but doesn't contract with them, so you would still have the opportunity to vet the franchisees and sign the agreement with them. So the area representative would attract but not contract with them, and then you could decide what ongoing support the area representative would provide.

**Interviewee**

Well pretty much well facets of each of these structures have worked into our organisation. This area representative basically they are a retailer of franchises. Our representation is through Name of Franchise Broker. So he is rewarded for that contact. So any contact in terms of business he is rewarded for. It is a one off commission payment.

**Interviewer**

Okay, I would say that Name of Franchise Broker is really a broker. This (area representation) person has the rights to provide ongoing services to the franchisee.

**Interviewee**

Oh I see so...

**Interviewer**

So it would be like saying you give Name of Franchise Broker the rights to do what they

do and provide ongoing support over the longer-term.

**Interviewee**

Okay so then definitely that one and I can see that this one is with looser ties the same sort of thing but with greyer areas.

**Interviewer**

Okay then this one here (pointing to subfranchising illustration) you would be giving a lot more responsibility basically to the subfranchisor. So they would attract and also manage, and they also contract with, franchisees themselves.

**Interviewee**

That one (subfranchising) would never feature. These two (sequential franchising and area development) would never feature. This (area representation) is more of a long-term objective or possibility. Like I say in some of the smaller areas and as far as development of a current scenario then you know that is a prime site that is a no go. This one (sequential franchising) would never work in our operation because the focus of what we require is we require is that owner operator right. So in other words this one has been taken completely out of the operation because no we don't want that. This one (area representation) is a possibility from how much control do we want but we always look at this position as being reasonably redundant because it must be more of a hands-on role. If we were going to pass on rights and any form of remuneration then you would expect that it would be more in this frame which is okay they are still franchised rights because we managed the franchising rights in other words 'hey we've always got to consider that we have got to be able to get rid of him (area representative) equally as well as any of these (franchisees) but we are in a position where we would go into this position with dealing with this individual who deals with the others.

**Interviewer**

With this one here (area representation) you can still delegate most of the ongoing support but the difference is that you would still - they wouldn't actually contract with each franchisee individually, but provide ongoing services. So you would still have more control over franchisees.

**Interviewee**

I see so this would be relinquishing control to the subfranchisees. Okay then I have got that wrong. It is this structure (subfranchising) that we wouldn't go to. So it is keeping this direct control of the franchisee that we would always want to maintain.

**Interviewer**

You would still [maintain direct control of franchisees] in this situation here (area representation). You can structure it... it is quite confusing, because you can structure it so many ways. But often what happens is that the subfranchisor is given the rights to go and develop the area pretty much autonomously. However, you can still have it written in to the agreement that the franchisee is contracted to the subfranchisor and the franchisor, so it is a three way...

**Interviewee**

...basically our current structure is this (single-unit franchising) with I think the facility to either operate something like this (area representation) or either or of these others (area representation or subfranchising). I mean we have factored in future growth right. That is about the franchisees contracting to Our Company Name and Our Company Name Limited can subcontract. The franchisees have absolutely zero rights over how the franchisor is structured. In other words we could actually sell the company to somebody else and the area would be protected under their agreements because they have trading rights for the company name and company rights etcetera so whoever purchased the company would have to satisfy the franchisees requirements for the period of their franchise. So we are very limited as to how we could do it but then restructuring of the franchisor operation can happen at any time. So we can evolve that in anyway that we want.

**Interviewer**

Okay, so this is interesting. So you find this one (area representation) perhaps more interesting than this one (subfranchising)?

**Interviewee**

Well if you give the direct... I mean from here what I say is my own argument up until now is that you need to cover all future options. But we need to maintain as direct a control as possible to protect the brand. Now that is in today's market. I mean once we develop a culture around the current franchising structure then we will be in a position to be making modifications and restructure as required. I mean it is still very early days. It is still pretty much like this (single-unit franchising) happening like that but then it may be that the Auckland operation is subcontracted into different structures similar to something like one of these (area representation or subfranchising).

**Interviewer**

And if you did subcontract, you would like to have it so that the person you subcontracted to had some sort of remuneration tied to their performance?

**Interviewee**

Tied to the performance. Totally tied to performance. The entire remuneration is tied to performance from an operator perspective. The franchisor. What we have done is that we have structured it so franchisees can't do anything unless we say that they can but they can't outsource anything either. In other words it is all through the organisation.

[Final 15 lines of interviewee's response deleted for commercial reasons].

**Interviewer**

Okay, so we have gone through that. Another area I would like to go through is the size of demand for mortgage broking. Say nationally. How do you define demand?

**Interviewee**

Well basically everybody who buys a home and takes out a mortgage requires finance. So we take a look at the total number of sales and look at that as demand. Everybody who has a mortgage is looking at refinancing at some stage or topping up or making some alteration so that is another market. So if we look at the mortgage market and we look at the structure of how that was delivered seven or eight years ago right when The Founder was starting out nine years ago now when The Founder was starting up that was handled

directly with the financial institutions. Now mortgage broking and the success of Name of Company and other broking services around the country has been that like we predict we are about 33 percent of the Christchurch market. That has gone back slightly from our hey day but then there are a lot more competitors in the market also. So even if we are solely what the market is and look at the total market being or if we can grab a third share of every market in New Zealand by operating the way we do there is quite a large market.

**Interviewer**

So do you look at your market then in terms of the number of sales or...

**Interviewee**

...well, we measure against sales

**Interviewer**

Volume number of house sales or...

**Interviewee**

...yeah pretty much. So one of the major statistics that we follow is basically house sales: total number of sales.

**Interviewer**

Is that 90 000 a year?

**Interviewee**

Something like that (begins reading a document).

**Interviewer**

Can I ask what that publication is?

**Interviewee**

Real Estate Institute. Total New Zealand 6376 for a reasonable month, January 99.



**Interviewer**

84 for the year?

**Interviewee**

Ah well that is a high month, so yeah I think you are closer to like 70 or 75 000 a year and depending on the year as well I mean we had a 30% reduction in house sales last year at various times of the year.

**Interviewer**

I understand it is a pretty good time for house sales

**Interviewee**

I mean you have got your peaks and your troughs. You have just got to go back to your basic rules of business and when you are doing figures you have got to look at the stability of your market and the way people are going to buy and sell properties. It is sort of like chocolate-coated wetas might have a very limited market or be a very niche market or be wiped out and people found that there were toxins in them so... But people buy and sell property so the stability of the market is pretty awesome and there are some traits of the market that you can trace back to doomsday. A property value will double every 10 years and that has been traceable. So there are some basic rules you have got to think are going to continue based on...

**Interviewer**

Okay, the demand size. Getting back to that. Do you so would you look at the number of house sales being the total market?

**Interviewee**

As our specialist area of business yeah. You have got to look at company philosophies now of certain companies. A lot of other companies will look at a base market and say lets diversify from that and represent a whole lot more products etcetera etcetera. What we are saying is that we will stick to our base business and there will be peripheral activities to support that because unlike consumables or anything else people purchase a property. It is a big part of their life and it remains a big part of your life so if we remain an integral part

of that we are going to get the next house sale. And the average term of a mortgage has decreased so people are either getting out of mortgage or moving more.

**Interviewer**

Okay, so we have got a good idea of what the total market size is in terms of sales. Do you translate that into what that equates to in terms of... so if you say there is 90 000 house sales or 80 000 house sales a year...

**Interviewee**

Our income is derived from basically the size of the mortgage. It is a percentage of the draw down. So our income is linked directly to that. It is not about fees or anything like that so we don't have to treat it as a commodity as much. But then it is also a case of you look at what it is that you are delivering. What services you are delivering. I mean if we are sitting in front of a customer there are other associated products which we can be presenting at the same time i.e., mortgage-related insurance which we are just entering into. So anything related to the mortgage that we can directly related to the mortgage then we will become active for other insurance services. We can farm out as well basically at a commission. So we can pass on the customer's details with their letter to other individuals who can also generate income for their organisation.

**Interviewer**

Can I ask you then if you consider the size of your market? If it was bigger would that make any impact on the type of franchising structure that you have here?

**Interviewee**

I think it would yeah. We would definitely move away from faster away from the simplistic you know (points to illustration of single-unit franchising)... If it was a case of structure because we are limited we have limited ourselves to the number of franchisees. Admittedly that is quite a high number because we do as a percentage against the population so it is always evolving. But we have limited that to x number so our structure will manage that number of individuals. But if it had been a case of well you know if we have got future plans which involve other individuals we may have had to go in with a different structure. At this stage there is not enough in mortgage broking; it is a limited

market, it is a readable market, so even if we maxed it out our requirement would never be any different...[Further] for our current sizing we are still able to concentrate on each market individually, we still have the resources in our organisation to do that. If it had the potential of 1000s of people working for us in Auckland, then we wouldn't come up with the structure that we have got. I think the structure has built around the criteria. It is like anything else, if you alter one part...if you tweak the motor the gearbox starts to whine.

**Interviewer**

So there is quite a strong relationship there, you are saying between perhaps the market size and the structure?

**Interviewee**

Definitely.

**Interviewer**

In terms of the size of the market, is it growing, the market for mortgage broking or is...

**Interviewee**

... it is, yes. At this stage it is growing. But again there are only so many properties for sale. Under current development we would have 50 years before this franchise system is out of date. The franchise system is licensed for 20 years so it will definitely fulfil the next 20 years requirements unless all of a sudden there is a population explosion in New Zealand and the requirement for properties and property sales quadruples then it would put pressure on us a lot sooner.

**Interviewer**

Now are you saying that property sales are pretty constant. But then you are talking about people's mortgage terms decreasing. Then presumably that's an increase in the size of your market actually?

**Interviewee**

It is, but then there are other factors in the market as well in that you look at the other businesses active in the market like our banks are our competitors. BNZ but they are always in a position to where they are attempting to grab back what they do. So in other words they are marketing activities. They are attempting to get the customer back direct. So they are always attempting to alter the market. Now you have got to think that we will never have a hundred percent of the market so we have got to make predictions that says... Our future strategic plan is based on there being a growth period still for mortgage broking but that has to... the difference between owning 35 percent and 45 per cent of the market is you know several times your investment so to own 45 percent of the market costs you more or very close to what owning 35 percent of the market costs you or more if you look at it in percentage terms. One of the other components is that we are comfortably out-stripping our competitors and miles ahead of our competitors in what we can actually spend on our business because of the structure so and we and again part of the franchise structure is that we still keep our fingers in the pie quite deep so that we can actually control the general business growth.

**Interviewer**

So if we think about the total demand for mortgage broking it sounds to me like it is fairly constant. It is not actually growing at a huge rate or...

**Interviewee**

... no. It would be growing I would say at about 20 percent a year. I mean and that's very hard to read. I mean for us we are riding the quest of a wave we can't measure because the measurement controls are completely out of our hands. It's not an open industry. I come from an industry like grocery. God you know every Moro bar that went through the tills on the Monday morning after the week that it was sold you can measure the time of day that it was sold so that when you put an ad on television you can actually physically measure impact of advertising on a period basis. So I come from a very controlled environment where you can totally measure what you do to a very measurable market. So from a marketing perspective I came back in the days of the Wild West. It is sort of like wow this is cowboy material.

**Interviewer**

There is a lot more uncertainty, less perfect information?

**Interviewee**

Yes, and a lot less understanding outside say the banks. Now they have some very good inside knowledge but they have the resources to develop that. So for us to develop the knowledge of our market would be the cost is just inhibitive. And you know so we are saying we have got a success formula it is working. We are milking it. We are investing in the business substantially and it is working and it is increasing. So where we can get measurements we are attempting to measure our business. But it is just you know it is just hey like the surfers say if you have got a big wave you don't let go do you. They all know they will crash to shore one day.

**Interviewer**

Okay, so with this growth, or this continued growth say, does that effect in any way the type of structure...

**Interviewee**

... it is pretty uncertain and where it will impact the business is that if the estimated growth falls short of the actual target. In other words we put ourselves on television and we are doing the things that drive the business along and then all of a sudden the exponential curve rockets. We are in a case where okay we have to constantly review what we need so need some very strong strategic planning for that like computers and how they are going to impact our business and how growth of internet activity is going to impact our business. Is that going to pull all of this back or is it going to or how can we as a marketing arm of an organisation represent better value to our franchisees by changing the direction of the company into those areas.

**Interviewer**

Okay, so I'm talking about total demand growth here, not just growth in your services. Presumably there is going to be some relationship between total demand growth and growth in your services. So if it did grow would that affect the type of franchising?

**Interviewee**

If it did then we would change the structure

**Interviewer**

How?

**Interviewee**

I see it as a progressive scale. In other words if you go down (from single-unit franchising to subfranchising) it is a progressive scale. Then you would move into this (area representation from single-unit franchising) which is a lighter weight version of this (subfranchising) if you see what I mean. Whereas this (area development) the only reason this one is totally discounted is because we don't want people employing people.

**Interviewer**

This one (sequential franchising) does that too.

**Interviewee**

Yep

**Interviewer**

So maybe from this (single-unit franchising) into...

**Interviewee**

...something like those (area representation then subfranchising, but not sequential franchising and area development). Because the core issue is we want individuals, right.

## **APPENDIX FOUR**

### **Observation Example**

(Appended to the interview transcript for SportCo's Managing Director)

SportCo's franchisor headquarters was located above their first and existing store. Once a company-owned store, it is now operated by a single-unit franchisee. The store and franchisor headquarters had different entrances. The entrance to headquarters came off a side street and led to stairs. The stairs led to a reception area. The reception area was in the middle of the building. A wide hallway went off in both directions. Offices led off the hallway in both directions. In total there were around six offices and one meeting room.

The interior and furnishings subtly reflected SportCo's branding. Furnishings were all modern and consistent throughout the floor. Like the building, they were neither flashy nor cheap in appearance. The founder and staff were smartly attired in 'business casual' styled clothing.

All offices, except the founder's, had computers.

During the visit, I also met two marketing executives and the Purchasing Manager. The Managing Director invited me to have lunch in SportCo's staff room. Here we joined the two marketing executives and the Purchasing Manager. Sandwich materials (e.g., bread, cheese, ham, lettuce, spreads etc) were kept in a fridge. Sandwich making appeared to be a shared and informal activity.

Employees came and went from the staff room. Some business matters were discussed during lunch. Discussions mostly involved issues relating to co-ordination, such as who was doing what and when. All interactions were civil and the Managing Director appeared to have a consultative style with employees.

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